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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

No. 873

THE QUAKER OATS COMPANY,

Appellant,

vs.

COMMONWEALTH OF PENNSYLVANIA

APPEAL FROM THE SUPREME COURT OF PENNSYLVANIA

STATEMENT AS TO JURISDICTION

In compliance with Rule 12 of the Supreme Court of the United States, The Quaker Oats Company, appellant, herewith submits its statement showing the basis of the jurisdiction of the Supreme Court of the United States to entertain an appeal in this cause.

I

Basis Upon Which It Is Contended that the Supreme Court of the United States Has Jurisdiction Upon Appeal to Review the Judgment in Question.

The judgment of the Supreme Court of Pennsylvania, a review of which is sought by this appeal, was dated and filed

on June 30, 1944, and made final on September 25, 1944, by the refusal by said Court of a Petition for Reargument, seasonably filed. It is a final judgment in a suit in the highest court of the State of Pennsylvania in which a decision in the suit could be had. In this suit, there was drawn in question the validity of a statute of the Commonwealth of Pennsylvania on the ground of its being repugnant to the Constitution of the United States. A decision on this question was necessary to the determination of the case, and the decision was in favor of its validity. Accordingly the Supreme Court of the United States has jurisdiction upon appeal to review the judgment in question. *Standard Oil Company of California* v. *Johnson,* 316 U. S. 481, 483, 86 L. Ed. 1611.

II

Statutory Provision Believed to Sustain the Jurisdiction

The statutory provision believed to sustain the jurisdiction of the Supreme Court of the United States upon appeal to review the judgment in question is Section 237 (a) of the Judicial Code of the United States, as last amended by the Act of February 13, 1925, C. 229, section 1, 43 Stat. 937, 28 U. S. C. A. 344 (a); and as modified by the Act of January 31, 1928, C. 14, 45 Stat. 54, as amended April 26, 1928, C. 440, 45 Stat. 466, 28 U. S. C. A. 861a-861b.

III

The Statute of the Commonwealth of Pennsylvania, the Validity of Which Is Involved

The statute of the Commonwealth of Pennsylvania which was held to be valid but which appellant contended was repugnant to the Constitution of the United States, is the Act of May 16, 1935, P. L. 184, (72 Purdon's Statutes, sections 1901-1902, 1871, 1891, 1892a-1892d), which amended Sec-

tions 20 and 21 of the Act of June 1, 1889, P. L. 420; and particularly Section 21 (b) thereof (72 Purdon's Statutes, sections 1871, 1891, 1892a-1892d). See Appendix for verbatim provisions of this Act.

Prior to the year 1935 both domestic corporations incorporated in Pennsylvania, and foreign corporations doing business in Pennsylvania, were subject to a tax upon the actual value of their whole capital stock, valued and appraised in the manner set forth in Section 20 of the Act of June 1, 1889, P. L. 420, as amended by the Act of April 25, 1929, P. L. 657.

The Act of May 16, 1935, P. L. 184, which amended Sections 20 and 21 of the Act of June 1, 1889, P. L. 420, (72 Purdon's Statutes, sections 1901-1902, 1871, 1891, 1892a-1892d), the validity of which is in question in this case, provided for the taxation of domestic and foreign corporations on different bases. Domestic corporations remained subject to the tax on capital stock, as they had been prior to 1935; but foreign corporations were subjected to a so-called franchise tax, imposed in lieu of the tax on capital stock which had been imposed upon such corporations prior thereto.

Section 21 (b) of the Act of 1935 provided, with respect to foreign corporations, that

> "The actual value of its whole capital stock of all kinds, including common, special, and preferred, shall be ascertained in the manner prescribed in the twentieth section of this Act, and shall be divided into three equal parts."

Under the twentieth section of said Act, the valuation and appraisal of the capital stock of domestic and foreign corporations was made in the same manner. Section 21 (b) of said Act then provided that the taxable portion of the capital stock of a foreign corporation should be computed by the application of a formula made up of three fractions

consisting of tangible property, payroll and receipts, the elements of which are elaborately set forth in the Act.

IV

Date of Judgment Sought to Be Reviewed and of Application for Appeal

The judgment of the Supreme Court of Pennsylvania sought to be reviewed was dated and filed on June 30, 1944.

On July 6, 1944, the appellant presented to said Court a petition to hold the record in the Supreme Court until August 1, 1944, which petition was duly granted July 10, 1944.

A petition for reargument was filed by the appellant in the Supreme Court of Pennsylvania on July 31, 1944, which petition was duly entertained and was refused on September 25, 1944. On the same date, an order was made by said Court to the Prothonotary to hold the record for ninety days to permit the prosecution of this appeal.

The application for appeal was presented on December 20, 1944.

V

Statement Showing That the Nature of the Case and the Rulings of the Court Were Such as to Bring the Case Within the Jurisdictional Provisions Relied Upon.

The Quaker Oats Company, the appellant, was incorporated under the laws of New Jersey to manufacture and deal in cereals and cereal products, where it had its legal domicile. During the year 1935, it had its principal office and place of business at Chicago, Illinois, which was its business or commercial domicile.

It was duly registered and doing business, as a foreign corporation, in Pennsylvania, prior to the enactment of

the Business Corporation Law of May 5, 1933, P. L. 364, 15 Purdon's Statutes, section 2852. On August 24, 1933, as required under the provisions of said Business Corporation Law, it applied for and received from the Commonwealth of Pennsylvania a Certificate of Authority authorizing it to transact as a foreign corporation in Pennsylvania the business of "selling and dealing in cereals and cereal products."

The appellant as required by the Act of May 16, 1935, P. L. 184, which amended Sections 20 and 21 of the Act of June 1, 1889, P. L. 420, (72 Purdon's Statutes, sections 1901-1902, 1871, 1891, 1892a-1892d), duly filed with the Department of Revenue of the Commonwealth of Pennsylvania a report for the year 1935, on the basis of which the taxing officers of the Commonwealth made their settlement in which they imposed upon the appellant a tax in the amount of $4,665.66, which amount was subsequently increased by the said taxing officers to $28,645.69. Appellant obtained a review and the tax was resettled at $16,-495.38.

The appellant thereupon filed an appeal in the Court of Common Pleas of Dauphin County, Pennsylvania, in which it contended inter alia, that the resettlement of tax, and the Act of May 16, 1935, P. L. 184, under the authority of which said resettlement had been made, were repugnant to the Constitution of the United States, because:

1. The tax which was imposed was in fact a tax on property, and the statute authorized its assessment in the said resettlement upon property of the appellant which had its situs for taxation outside of the Commonwealth of Pennsylvania, and beyond its taxing jurisdiction.

2. Even if the tax were determined to be a tax upon the franchise or privilege of doing business in Pennsylvania, nevertheless the method of allocation or apportionment of

that part of the capital stock of appellant to be taxed by the Commonwealth of Pennsylvania was arbitrary, unreasonable and capricious; did not bear any just or reasonable relation to the value of the property of appellant which was employed in Pennsylvania or which had its situs for taxation therein; and resulted in imposing a tax upon property of the appellant which was employed or which had its situs outside of the Commonwealth and beyond its jurisdiction—all of which denied to appellant the due process of law in violation of the Fourteenth Amendment to the Constitution of the United States.

3. The provisions of the said Act under which foreign corporations are classified and taxed separately on the basis of difference in domicile only (R. 192a), deny to foreign corporations the equal protection of the laws in violation of the Fourteenth Amendment to the Constitution of the United States because the exemptions that are allowed to domestic corporations for capital stock tax purposes are not allowed to foreign corporations of the same kind.

4. The said resettlement of tax made against appellant denies to it the equal protection of the laws in violation of the Fourteenth Amendment to the Constitution of the United States because therein exemption is not allowed to it for investments in United States securities and shares of subsidiary corporations more than 50% owned, which are allowed to domestic corporations of the same kind for capital stock tax purposes.

5. The provisions of said Act and the resettlement of tax made thereunder against appellant impair the obligation of the contract between appellant and the Commonwealth of Pennsylvania in violation of Article I, Section 10 of the Constitution of the United States because no pro-

vision is made in said Act for the allowance of an exemption to appellant, and no exemption is allowed in said resettlement to appellant, for its investments in United States securities and shares of subsidiary corporations more than 50% owned, which are allowed to domestic corporations of the same kind for capital stock tax purposes.

6. As applied to the appellant, the provisions of said Act and the resettlement of tax made thereunder against appellant, unduly and unlawfully burden and regulate interstate commerce in violation of Article I, Section 8, of the Constitution of the United States where the total receipts from certain interstate transactions were included in the numerator of the gross receipts allocation fraction.

The trial court, after making minor modifications in the three statutory allocation fractions and in the valuation of appellant's capital stock value, determined the amount of tax owing by appellant to be $16,637.38; specifically overruled each of the contentions made by appellant; and upheld the validity of the said Act of May 16, 1935, P. L. 184.

On appeal to the Supreme Court of Pennsylvania from the findings, conclusions, rulings and judgment of the trial court, appellant made the same contentions as before the trial court. In affirming the judgment of the trial court, the Supreme Court of Pennsylvania overruled specifically each contention made by appellant and upheld the validity of the said Act of May 16, 1935, P. L. 184.

VI

The Stage in the Proceedings in the Court of First Instance and in the Appellate Court, at Which, and the Manner in Which, the Federal Questions Sought to Be Reviewed Were Raised, the Method of Raising Them, and the Way in Which They Were Passed Upon by the Court; the Rulings of the Court Thereon to Show That the Case Is Brought Within the Statutory Provision Believed to Confer Jurisdiction on This Court.

The first question as stated above was raised by appellant in the 8th, 9th, 15th and 16th paragraphs of its Appeal and Specifications of Objections filed with the trial court, (R. 4a, 5a, 9a and 10a) and more fully stated in appellant's 1st, 3rd and 4th Requests to the trial court for Conclusions of Law (R. 189a, 190a), which read as follows:

> "1. The tax imposed upon a foreign corporation by the provisions of Section 21, paragraph (b), of the Act of June 1, 1889, P. L. 420, as amended by the Act of May 16, 1935, P. L. 184, is a tax upon so much of the capital stock of such corporation as is allocated to the Commonwealth of Pennsylvania by the method prescribed therein, and as such it is a tax upon the assets and property of the corporation and not upon any franchise or privilege, or the exercise thereof."

> "3. The provisions of Section 21, paragraph (b), of the Act of June 1, 1889, P. L. 420, as amended by the Act of May 16, 1935, P. L. 184, are unconstitutional and void because they violate the provisions of Section 1 of the Fourteenth Amendment to the Constitution of the United States in that they deprive the defendant of its property without due process of law by imposing a tax upon property of the defendant which has its situs outside the Commonwealth of Pennsylvania and beyond its taxing jurisdiction."

"4. The settlement of tax appealed from is unconstitutional and void because it violates the provisions of Section 1 of the Fourteenth Amendment to the Constitution of the United States in that it deprives the defendant of its property without due process of law by imposing a tax upon property of the defendant which has its situs outside the Commonwealth of Pennsylvania and beyond its taxing jurisdiction."

The second question as stated above was raised by appellant in the 12th and 14th paragraphs of its Appeal and Specifications of Objection filed with the trial court (R. 7a, 8a, 9a) and more fully stated in appellant's 9th and 10th Requests to the trial court for Conclusions of Law (R. 191a, 192a), which read as follows:

"9. The provisions of Section 21, paragraph (b), of the Act of June 1, 1889, P. L. 420, as amended by the Act of May 16, 1935, P. L. 184, are unconstitutional and void because they violate the provisions of Section 1 of the Fourteenth Amendment to the Constitution of the United States by depriving the defendant of its property without due process of law, in that the method prescribed therein for assigning or allocating to the Commonwealth of Pennsylvania that portion of the capital stock of the defendant which is subject to taxation by the Commonwealth of Pennsylvania, is arbitrary, unreasonable and capricious, does not bear any just or reasonable relation to the value of the property of the defendant which has its situs for taxation within the Commonwealth of Pennsylvania, and results in imposing a tax upon property of the defendant which has its situs outside of the Commonwealth and beyond its taxing jurisdiction."

"10. The settlement of tax appealed from is unconstitutional and void because it violates the provisions of Section 1 of the Fourteenth Amendment to the Constitution of the United States by depriving the defendant of its property without due process of law, in that

the method therein applied in assigning or allocating to the Commonwealth of Pennsylvania that portion of the capital stock of the defendant which is subject to taxation by the Commonwealth of Pennsylvania, is arbitrary, unreasonable and capricious, does not bear any just or reasonable relation to the value of the property of the defendant which has its situs for taxation within the Commonwealth of Pennsylvania, and does, in fact, impose a tax upon property of the defendant which has its situs outside of the Commonwealth and beyond its taxing jurisdiction."

The third question as stated above was raised by appellant in the 23rd paragraph of its Appeal and Specifications of Objection filed with the trial court (R. 13a), and more fully stated in appellant's 11th, 13th and 15th Requests to the trial court for Conclusions of Law (R. 192a, 193a, 194a), which read as follows:

"11. The defendant, having been duly authorized and qualified by the laws of the Commonwealth of Pennsylvania to do business in this state, is entitled to the equal protection of its laws; and it cannot be subjected to taxation which will impose upon it burdens which are substantially different or greater than those imposed upon domestic corporations of the same class."

"13. If the provisions of Section 21, paragraph (b), of the Act of June 1, 1889, P. L. 420, as amended by the Act of May 16, 1935, P. L. 184, were to be construed as imposing a tax upon the franchise or privilege of doing business in Pennsylvania by the defendant, they would be unconstitutional and void because they would violate the provisions of Section 1 of the Fourteenth Amendment to the Constitution of the United States by depriving the defendant of the equal protection of the laws, in that they would impose upon the defendant a tax for the franchise or privilege of doing business in Pennsylvania, while at the same time no similar tax is imposed upon domestic corporations of the same class for the franchise or privilege of doing business in Pennsylvania."

"15. The provisions of Section 21, paragraph (b), of the Act of June 1, 1889, P. L. 420, as amended by the Act of May 16, 1935, P. L. 184, are unconstitutional and void because they violate the provisions of Section 1 of the Fourteenth Amendment to the Constitution of the United States, in that they discriminate against foreign corporations and in favor of domestic corporations by including in the taxable value of the capital stock of foreign corporations subject to tax thereunder, the value of securities of the United States, and the value of the shares of stock of other foreign corporations a majority of whose voting stock is owned by the foreign corporation taxed, and all or a part of whose property and assets have a legal situs outside of Pennsylvania, although under the provisions of the Act of June 22, 1931, P. L. 687, a domestic corporation owning a majority of the voting stock of a foreign corporation would not be subject to taxation upon so much of the value of such shares as represented property or assets located or having a legal situs outside of Pennsylvania, nor upon the value of its capital stock invested in securities of the United States."

The fourth question as stated above was raised by appellant in the 23rd paragraph of its Appeal and Specifications of Objection filed with the trial court (R. 13a), and more fully stated in Appellant's 14th and 16th Requests to the trial court for Conclusions of Law (R. 193a, 194a), which read as follows:

"14. If the tax imposed by the settlement appealed from be construed as a tax upon the franchise or privilege of doing business in Pennsylvania by the defendant, then the said settlement is unconstitutional and void because it violates the provisions of Section 1 of the Fourteenth Amendment to the Constitution of the United States, by depriving the defendant of the equal protection of the laws, in that it imposes upon the defendant a tax for the franchise or privilege of doing business in Pennsylvania although the laws of the Commonwealth of Pennsylvania do not impose any

similar tax upon domestic corporations of the same class for the franchise or privilege of doing business in Pennsylvania."

"16. The settlement of tax appealed from is unconstitutional and void because it violates the provisions of Section 1 of the Fourteenth Amendment to the Constitution of the United States, in that it discriminates against the defendant and in favor of domestic corporations by including in the taxable value of the capital stock of the defendant the value of securities of the United States, and the value of the shares of stock of other foreign corporations a majority of whose voting stock is owned by the defendant, and all or a part of whose property and assets have a legal situs outside of the Commonwealth of Pennsylvania, although under the provisions of the Act of June 22, 1931, P. L. 687, a domestic corporation owning a majority of the voting stock of a foreign corporation is not subject to taxation upon so much of the value of such shares as represents property or assets located or having a legal situs outside of Pennsylvania, nor upon the value of its capital stock invested in securities of the United States."

The fifth question as stated above was raised by appellant in the 29th paragraph of its Appeal and Specifications of Objection filed with the trial court (R. 15a), and more fully stated in Appellant's 17th and 18th Requests to the trial court for Conclusions of Law (R. 194a, 195a), which read as follows:

"17. The provisions of Section 21(b) of the Act of June 1, 1889, P. L. 420, as amended by the Act of May 16, 1935, P. L. 184, are unconstitutional and void because they violate the provisions of Article I, Section 10, of the Constitution of the United States by impairing the obligation of the contract between the defendant and the Commonwealth of Pennsylvania, the terms of which provided that the defendant should enjoy the same rights and privileges as a domestic corporation

and should not be subject to any greater liabilities, restrictions, duties or penalties."

"18. The settlement of tax appealed from is unconstitutional and void because it violates the provisions of Article I, Section 10, of the Constitution of the United States by impairing the obligation of the contract between the defendant and the Commonwealth of Pennsylvania, the terms of which provided that the defendant should enjoy the same rights and privileges as a domestic corporation and should not be subject to any greater liabilities, restrictions, duties or penalties."

The sixth question as stated above was raised by appellant in the 26th paragraph of its Appeal and Specifications of Objection filed with the trial court (R. 14a), which reads as follows:

"26. As applied to the appellant, the Act of May 16, 1935, P. L. 184, under the supposed authority of which the settlement of tax here appealed from was made, and the said settlement of tax are unconstitutional, illegal and void, because they violate the following provisions of Article I, Section 8, of the Constitution of the United States:

"The Congress shall have Power • • •

• • • • • • •

"To regulate Commerce with foreign nations, and among the several States, • • •"

for the reason that the necessary effect of the said Act as construed and applied and of the settlement as made is to burden and regulate, unduly and unlawfully, interstate commerce, since receipts from interstate commerce transactions have been included in the numerator of the third statutory allocation fraction."

The appellant urged these questions in its exceptions to the findings of fact, conclusions of law, opinion and judg-

ment nisi of the trial court and in its assignment of errors, brief and argument in the Supreme Court of Pennsylvania. These questions were specifically overruled and the validity of the tax statute was upheld by the trial court in its opinion, in its refusal to find Conclusions of Law as requested by the appellant and in overruling appellant's exceptions to its findings of fact and conclusions of law, its opinion and judgment nisi; and by the Supreme Court of Pennsylvania in its opinion in affirming the judgment of the trial court.

VII

Statement of the Grounds Upon Which It Is Contended That the Questions Involved Are Substantial

The constitutional questions decided by the Supreme Court of Pennsylvania are substantial and important. They have either not been passed upon by the Supreme Court of the United States or have been decided contrary to the rulings of the trial court and the Supreme Court of Pennsylvania, as will hereinafter be indicated.

(a)

The nature of the tax and the taxation of property beyond the taxing jurisdiction

The question is presented whether the tax imposed on foreign corporations by the Act of May 16, 1935, P. L. 184, which amended Sections 20 and 21 of the Act of June 1, 1889, P. L. 420 (72 Purdon's Statutes, sections 1901-1902, 1871, 1891, 1892a-1892d), is a tax on property or a tax on the franchise of doing business in Pennsylvania. If the former, then clearly the tax on appellant is imposed on its property beyond the taxing jurisdiction and is imposed upon United States securities owned by appellant because the only property employed by appellant in Penn-

sylvania amounted to $22,440 (R. 179a, 180a, 183a) and the taxable value of appellant's franchise as determined is $3,327,426.

Prior to 1935, the capital stock of both domestic and foreign corporations, at an appraised actual cash value, was taxed under Sections 20 and 21 of the said Act of 1889. This tax was held to be a tax on property.

Delaware, Lackawanna & Western R. R. Co. v. *Pennsylvania,* 198 U. S. 341;
Commonwealth v. *Standard Oil Co.,* 101 Pa. 119.

The said Act of 1935, which amended Sections 20 and 21 of the Act of 1889, continued in Section 21(a) the tax on domestic corporations as theretofore, and in Section 21(b), imposed tax on "the taxable value" of the capital stock of foreign corporations to be determined by the formula provided therein. The basis of the tax on both domestic and foreign corporations continued to be the *appraised* actual value in cash of the whole capital stock as provided in Section 20. In Section 21(c) it is provided that domestic and foreign corporations liable to tax under Section 21 "shall not be required to pay any *further* tax on the mortgages, bonds, and other securities owned by them * * *." (Italics ours.) This is indicative that the tax imposed on foreign corporations under Section 21(b) is a tax on property.

A tax upon property or measured by property *according to a valuation* is a property tax because in such tax one of the incidents of the tax is that the tax burden increases or decreases as the value of the property fluctuates; but a tax measured by property *not requiring a valuation and imposed directly by the Legislature* is a franchise tax. In the cases of *Bank of Commerce* v. *New York City,* 2 Black 620 (1862); *Bank Tax Case,* 2 Wall. 200 (1864); and *Society for Savings* v. *Coite,* 6 Wall. 594 (1867), this dis-

tinction is made clear and has been adhered to since that time. Under this test, the tax imposed on foreign corporations under the said Act of 1935 is a property tax. The decisions of the Supreme Court of the United States, arising under the franchise tax statutes of other states are not decisive of this issue since there the tax is measured by capital stock or property, *not requiring a valuation,* and is imposed directly by the Legislature. As illustrative see:

International Shoe Co. v. *Shartel,* 279 U. S. 429;
Ford Motor Co. v. *Beauchamp,* 308 U. S. 331.

Furthermore, the opinions of the Supreme Court of Pennsylvania on this question are inconsistent. In the instant case, 350 Pa. 253, 38 A. (2d) 325, where that Court relied upon its opinion in *Commonwealth* v. *Columbia Gas & Electric Corp.,* 336 Pa. 209, 8 A. (2d) 404, it was held that the tax was on the franchise or privilege of doing business in Pennsylvania. In *Arrott's Estate,* 322 Pa. 367, 185 Atl. 697, and in *Commonwealth* v. *Union Trust Company of Pittsburgh,* 345 Pa. 298, 25 A. (2d) 294, it was held that the tax on foreign corporations is in effect "a tax on capital stock" and that "the property included within the folds of the Franchise Tax Act embraces the same elements upon which the capital stock tax was based."

In the title of said Act of 1935, it is stated that there is being substituted "a franchise tax on foreign corporations in lieu of the capital stock tax on such corporations." No mention is made in Section 21(b) or elsewhere that the tax is on the franchise privilege of doing business in Pennsylvania. The tax imposed on the property of foreign corporations prior to 1935 cannot be converted into a privilege tax by *calling* it such. The Supreme Court

of the United States should take jurisdiction to determine the character of the tax by its operations and by its incidents.

Educational Films Corp. v. *Ward*, 282 U. S. 379, 387;
The Macallen Co. v. *Mass.*, 279 U. S. 620, 625, 626;
Schuylkill Trust Co. v. *Pennsylvania*, 296 U. S. 113, 119.

(b)

Is the method of allocation provided in the Act of 1935 inherently arbitrary and unreasonable?

The Supreme Court of Pennsylvania upheld the validity of the method of allocation consisting of tangible property, payroll and receipts fractions for the reason that the use of one or more of these fractions had been approved by the Supreme Court of the United States in the following cases arising under the franchise tax statutes of other states:

Ford Motor Co. v. *Beauchamp*, 308 U. S. 331;
Roberts & Schaefer Co. v. *Emmerson*, 271 U. S. 50;
International Shoe Co. v. *Shartel*, 279 U. S. 429.

These cases are not decisive of the issue for the following reasons:

1. In these cases, the franchise tax based on "capital stock" does not require a valuation and is imposed directly by the Legislature. "Capital stock" as used means the business capital of the corporation as shown by its books irrespective of asset, property or going concern values and does not include the value of good will, franchise, or privileges. Under the Pennsylvania Act of 1935, the actual value in cash of the whole capital stock of foreign corporations, which is the basis of the tax under said Act, does

require a valuation and appraisal. The tax is not imposed directly by the Legislature; and capital stock as used represents all property and assets at going concern values and includes the value of good will, franchises or privileges.

2. In the *Ford Motor Co.* case, the allocation fraction of gross receipts from *intrastate* business over total gross receipts was used. In the instant case, there have been included in the numerator of the gross receipts fraction not only *intrastate* receipts, but *all* of the receipts from *interstate* transactions in which the orders were negotiated from Pennsylvania sales offices but the sales were consummated outside Pennsylvania. We will further distinguish this case at a later point.

3. In the *Shartel* case, the allocation fraction used was that of tangible and intangible assets in the taxing state over total assets; and the allocation fraction used in the *Emmerson* case was that of tangible and intangible assets in the taxing state plus volume of business in the state over total assets plus total volume of business. In the latter case, the addition of the business factor did not produce an average percentage in excess of the percentage of the asset factor. In both cases, intangible assets were allocated by the application of the rules of business situs; and in both cases, since the whole capital stock was used as the basis of the tax, representation was given in the allocation fraction to the *entire* enterprise when the factor of total assets was used. *The situation is entirely different in the instant case.* Here, 58% of appellant's total assets is comprised of intangible assets. The actual value of appellant's whole capital stock represents the value of its assets and franchises everywhere, and when the three allocation fractions (as provided in the Act of 1935 which excludes intangibles and does not give representation to all sources of value) are applied to appellant's whole capital stock value, an

unconstitutional result is produced. See *People ex rel. Alpha Portland Cement Co.* v. *Knapp*, 230 N. Y. 48, 129 N. E. 202, certiorari denied 256 U. S. 702.

Furthermore, the Pennsylvania Supreme Court, conceding that the three Pennsylvania allocation fractions are representative of *business activity* producing *net income*, holds that they are equally appropriate either for the determination of a franchise tax based on capital stock or on net income, citing *Butler Bros.* v. *McColgan*, 315 U. S. 501. This conclusion is erroneous because:

1. When the Legislature selects net income as the basis of the tax, the taxable value of the franchise is greater or less depending upon the amount of net income or the amount of business produced by its exercise; but when, as in the Act of 1935, capital stock representing property and assets value is selected as the basis of the tax, the taxable value of the franchise depends upon the amount of capital employed in its exercise in the taxing state. The Supreme Court of Pennsylvania had confused these two different standards or measures of the value of the franchise which is taxed.

2. Different business functions or activities producing income require employment of varying amounts of capital or assets so that there can be no presumption that capital or property is employed in the same ratio as business activities. This is recognized in the states imposing both a franchise tax based on capital stock and on income where different allocation fractions are used for each tax. The Massachusetts statute is illustrative. It imposes a tax on domestic and foreign corporations with respect to the carrying on or doing of business within the state. The tax is computed on two bases: the one, on corporate excess consisting of the capital stock value of intangible assets, which is allocated by the use of a single fraction made up of *the*

value of tangible and intangible assets employed in the state over total assets; and the other on net income, which is allocated by the use of the same three fractions as are provided in the Pennsylvania Act of 1935. See *Atlantic Lumber Co.* v. *Commission,* 298 U. S. 553, and *Alpha Portland Cement Co.* v. *Mass.,* 268 U. S. 203.

3. The allocation fractions in the *McColgan* case are representative only of business activities producing the principal business income and are used only to allocate such income, the income from intangibles being specifically allocated according to situs of the intangibles.

(c)

Even if the tax imposed by the Act of 1935 be a franchise tax, does the method of allocation used result in imposing tax upon, or measuring the tax by, property of appellant located and employed outside of Pennsylvania?

The Supreme Court of Pennsylvania held that it did not. Having found that all of appellant's property no matter where located and employed were used in a unitary enterprise, and that their use affected the value of the Pennsylvania franchise, it said:

> "The tax is not imposed *upon* any of this property, but upon the value of the Pennsylvania franchise, *measured* by the capital stock related to the business activity of appellant in this State. The right of the State to use such a measure to reasonably determine the enhancement of the value of the local franchise by the employment of extra-territorial property is fully discussed in the Ford Motor Company case and need not be here reviewed."

Relying upon its prior decision in *Commonwealth* v. *Columbia Gas and Electric Corp.,* 336 Pa. 209, 8 A (2d) 404, the court held that the use of the three allocation fractions

as provided in the Act of 1935, applied to the whole capital stock value of appellant's unitary enterprise, was a reasonable and just attempt to determine the enhanced value of the local franchise exercised by appellant in Pennsylvania.

It is submitted that the taxable value of appellant's franchise in Pennsylvania as so determined is based upon the value of appellant's property located and employed outside of Pennsylvania and that such result is contrary to the decisions of the Supreme Court of the United States.

The Supreme Court of Pennsylvania confuses two different standards or measures of the value of a franchise, the one based on net income and the other based on capital stock representing property and asset values, and applies the same principles to both. When net income is the measure, an allocation, based on the business activities producing the income, is proper. In the instant case, capital stock made up *wholly* of property and asset values is the measure. Therefore, the allocation ought to be made on the basis of property and assets *producing* the capital stock value.

The vice in the instant case is in the method of allocation as was found in *Fargo* v. *Hart*, 193 U. S. 490, 502. When the three allocation fractions of tangible property, payroll and receipts, *in which no representation is given to appellant's intangible assets comprising 58% of its total assets,* are applied to appellant's whole capital stock value (with a minor exception), there is mathematically allocated to Pennsylvania the capital stock value of *all* of appellant's intangible assets to the extent of the average percentage of the allocation fractions. And this is done regardless of the location, situs and use of the intangibles. This is particularly true of appellant's investments in United States, state, county, and municipal securities which were located and employed wholly outside of Pennsylvania (R. 178a); and in

shares of subsidiary corporations which had no property and conducted no business in Pennsylvania (R. 178a). On the authority of *National Leather Co.* v. *Mass.*, 277 U. S. 413, property and assets not located *or* employed in the taxing state may not be included in the taxable value of the franchise based on property and asset values.

Under the method of allocation used in the instant case, the result is not the determination of the true value of property and assets employed in the exercise by appellant of its franchise in Pennsylvania as correlated with all its property and assets; but, on the other hand, the result is produced of adding to the value of appellant's property and assets in Pennsylvania the value of its assets located and employed wholly outside of Pennsylvania.

Under the circumstances, the Supreme Court of the United States has held that whether the tax be a property or franchise tax, the tax may not be imposed upon or measured by property and assets located or employed, or upon activities carried on, outside of the taxing state.

James v. *Dravo Contracting Co.*, 302 U. S. 134;

Connecticut General Life Ins. Co. v. *Johnson*, 303 U. S 77;

Wallace v. *Hines*, 253 U. S. 66, 69, 70;

Fargo v. *Hart*, 193 U. S. 490;

Delaware, Lackawanna & Western R. R. Co. v. *Pennsylvania*, 198 U. S. 341.

(d)

The case of *Ford Motor Co.* v. *Beauchamp*, 308 U. S. 331

This case, relied upon by the Supreme Court of Pennsylvania, is not applicable in the instant case for the following reasons:

1. As construed in *Southern Realty Co.* v. *McCallum*, 65 F. (2d) 934, certiorari denied, 290 U. S. 692, the Texas statute grants a limited license to do business for one year,

which must be renewed. It is in the nature of an entrance fee charged at the time of admission to do business, such as was involved in *Atlantic Refining Co.* v. *Virginia*, 302 U. S. 22. The tax is imposed at the beginning of the year, and is for the opportunity to do the year's business measured *by the business capital or business potency about to be used.* After payment of the tax, the corporation may employ *all* its capital and business potency in its business in Texas without increasing the amount of the tax for that year. For this reason, the origin, form, and location of capital at the time the tax is charged is not important. It is granted the privilege to employ all its capital and if it does not, that is no concern of the state.

2. The amount of the tax is fixed and does not vary with the amount of capital employed or business done during the tax year. If the tax is not paid by July 1st, the right to do business is forfeited. No provision is made for assessment and distraint of the tax. If the tax report and payment of tax is rejected, the Attorney General must file suit for collection.

3. The situation in Pennsylvania is wholly different:

(a) The Certificate of Authority is granted for an unlimited period of time, and may be revoked only for cause. The fee paid for it is not connected with the disputed tax in the instant case.

(b) The franchise tax, if so it be, is imposed *after* the year's business for the privilege of having exercised its franchise and is measured by the amount of capital that was actually employed. Therefore, location, and use of capital employed are important.

(c) Provisions exist for assessment and distraint of the tax. Failure to pay the tax does not result in the forfeiture of the right to do business.

(e)

Do the Act of 1935 and the tax imposed on appellant thereunder deny to it the equal protection of the laws?

Appellant owned United States securities valued at $14,901,015 (R. 178a) and shares of subsidiary corporations valued at $1,663,499 (R. 177a, 178a). Prior to 1935, such investments when owned by both domestic and foreign corporations were not taxed. Under the Act of 1935 which retained the same basis of tax on both domestic and foreign corporations, to wit, the actual value in cash of the whole capital stock, such investments were included in the computation of the tax on appellant and increased its tax by $4,537.61 but were exempted from tax when owned by domestic corporations of the same kind. Thus the tax base for domestic corporations is less than the whole because of exemptions allowed but the tax base of appellant and other foreign corporations is *the full amount* of the capital stock value attributed to Pennsylvania.

The Supreme Court of Pennsylvania held that this difference in treatment of such investments for tax purposes under the Act of 1935 did not deny to appellant the equal protection of the laws. It cited the case of *Kansas City, etc. & R. R. Co.* v. *Stiles*, 242 U. S. 111, for the proposition that "a state may differentiate in its method of taxing between domestic and foreign corporations", but it is submitted that this case held that the domiciliary state could impose a greater tax burden on its creatures than on foreign corporations, and, therefore, does not support the converse proposition.

It held also that since the tax on appellant was a franchise tax, the investments were not taxed but were used only in the *measurement* of the base of the tax. Even so, it is submitted that the tax burden on appellant has been in-

creased by the inclusion of such investments in the computation of the tax.

It further held that, in any event, appellant is not discriminated against because, if it were a domestic corporation and its intangible assets had a domiciliary situs in Pennsylvania, it would pay a greater tax than that imposed on it. No authority is cited for this proposition in disposing of appellant's contention of denial of equal protection of the laws. It is without support in the law and presupposes a situation that doesn't exist.

The decisions of the Supreme Court of the United States in *Southern Railway Co.* v. *Greene*, 216 U. S. 400, and in *Hanover Fire Insurance Co.* v. *Harding*, 272 U. S. 494, are contrary to the rulings of the Supreme Court of Pennsylvania on the question presented. These cases hold that foreign corporations, *after having been admitted to do business*, stand equal and are to be classified with domestic corporations of the same kind. In these two cases, the foreign corporations were held to be denied the equal protection of the laws; in the *Greene* case, because a franchise tax measured by capital employed was imposed on the foreign corporation and not on domestic corporations of the same kind, and in the *Harding* case, because a foreign fire insurance company was taxed upon 100% of the full value of its net receipts whereas domestic fire insurance companies were taxed upon only 30% of the full value of personal property, net receipts having been construed as personal property.

(f)

Do the Act of 1935 and the tax imposed on appellant thereunder impair the obligation of the contract between appellant and the Commonwealth?

The appellant contended that a contract between it and the Commonwealth was created by the Act of May 28, 1907,

P. L. 226, which was later repealed and its provisions written into Section 1010 of the Business Corporation Law of May 5, 1933, P. L. 364, 15 Purdon's Statutes, section 2852. That section provides:

> "A foreign corporation, which shall have received a Certificate of Authority under this act, * * *, shall be subject to the same liabilities, restrictions, duties and penalties now in force or hereafter imposed upon domestic corporations * * *."

The appellant contended that the provisions of the contract were impaired when its investments in United States securities and in shares of subsidiary corporations were included in the computation of the tax on it under the Act of 1935 and its tax thereby increased to the extent of $4,537.61, whereas such investments were exempted from tax when owned by domestic corporations of the same kind.

The Supreme Court of Pennsylvania, without discussing whether a contract existed and what its terms were, disposed of this constitutional objection of appellant by holding that appellant had failed to prove discrimination by the State against it as a foreign corporation. This conclusion is based upon the assumption that an equivalent tax burden is imposed on domestic and foreign corporations under the Act of 1935. That assumption, in turn, is based upon a comparison of the tax which appellant would pay if it were a domestic corporation and its intangible assets had a domiciliary situs in Pennsylvania, with the tax imposed on it as a foreign corporation.

Here again no authority is cited for the use of any such comparison in support of the conclusion reached. The comparison is without authority in the law and is based upon a situation that doesn't exist.

The decision of the Supreme Court of the United States in the case of *American Smelting and Refining Co.* v.

Colorado, 204 U. S. 103, is contrary to the ruling of the Supreme Court of Pennsylvania, on the question presented. There it was held that the provisions of the Colorado law which were similar to the provisions of Section 1010 of the Pennsylvania Business Corporation Law of 1933 created a contract with foreign corporations, *after they had been admitted to do business,* which guaranteed to them equality of taxation with domestic corporations; and that this contract was impaired by an Act imposing a state license tax on domestic corporations at the rate of *two cents* upon each $1,000 of their capital stock and on foreign corporations at the rate of *four cents* upon each $1,000 of their capital stock. In the instant case, although the tax rate on both domestic and foreign corporations is five mills, the allowance of exemptions to domestic corporations that are not allowed to foreign corporations produces in effect a lower tax rate for domestic corporations.

(g)

Does the Act of 1935 as construed and applied in imposing tax on appellant unduly and unlawfully burden interstate commerce?

All of appellant's manufacturing plants were outside of Pennsylvania. It had an extensive sales organization throughout the United States. Two sales offices were located in Pennsylvania, one at Pittsburgh and the other at Philadelphia. At each location, a small inventory of goods was kept in a public warehouse. Salesmen connected with these two offices obtained orders which gave rise to sales in the amount of $7,224,347.

Except for sales of $171,773 made from Pennsylvania stocks to Pennsylvania customers the remainder of the sales in the amount of $7,052,574, arising from orders obtained by the Pennsylvania sales offices, were made in in-

terstate commerce. They were controlled by, and approved or rejected at, appellant's home office in Chicago. There, the customers' credit was passed upon, their accounts were kept, and invoices were made out. Shipments were made from stocks or from mills outside of Pennsylvania direct to the customers, and remittances were made to Chicago.

In the computation of the tax against appellant the intrastate receipts of $171,773 and the *whole* of the interstate receipts of $7,052,574 were used in the numerator of the gross receipts allocation fraction.

Appellant contended that the use of the *whole* of the interstate receipts, instead of only a part thereof attributable to that proportion of the interstate transaction in Pennsylvania, unduly and unlawfully burdened interstate commerce.

The Supreme Court of Pennsylvania rejected appellant's contention. It said:

> "* * * the tax is imposed upon the privilege of doing business here, measured by capital stock. It is in no sense a tax on sales or on interstate transactions. Sales enter into the determination of the tax only as an index of business activity in this State. * * * The burden imposed by the Act of 1935 is incidental and reasonable."

The fault with the Court's reasoning is that it has used the *whole* of the interstate sales as representing Pennsylvania activities; and the use of these receipts produces $13,343.63 of the tax of $16,637.38 imposed on appellant. The cases cited by the Court arose under wholly different facts than those in the instant case.

The decisions of the Supreme Court of the United States are contrary to the ruling of the Supreme Court of Pennsylvania on the question presented.

The use of the *whole* of the interstate receipts has been approved only where local management and manufacturing activities in the taxing state preceded the sale and where the amount of the tax did not exceed that which could have been imposed directly on the property;

Hump Hairpin Manufacturing Co. v. *Emmerson,* 258 U. S. 290;

United States Glue Co. v. *Town of Oak Creek,* 247 U. S. 321.

or where the *whole* of the interstate activity was carried on in the taxing state;

Western Live Stock v. *Bureau,* 303 U. S. 250.

In the instant case, appellant had property of only $22,440 employed in Pennsylvania (R. 179a, 180a) and all its local management and manufacturing activities were carried on outside of Pennsylvania.

Where gross receipts are used to measure the true value of property and capital employed in the taxing states—as appears to be the theory in the instant case—the Supreme Court of the United States has approved the use of intrastate receipts and *the part* of the interstate receipts attributable to the taxing state,—

Maine v. *Grand Trunk Rwy. Co.,* 142 U. S. 217;
Cudahy Packing Co. v. *Minnesota,* 246 U. S. 450;
Pullman Co. v. *Richardson,* 261 U. S. 330.

In *Matson Navigation Co.* v. *State Board,* 297 U. S. 441, the use by California of only 22.2% of interstate receipts was approved. Under the Texas statute, no interstate receipts are used, it being stated in *Ford Motor Co.* v. *Beauchamp,* 308 U. S. 331, at p. 335:

> "The tax here levied is not for the privilege of engaging in any transaction across state lines or activity carried on in another state."

VIII

Opinions

We are including in the Appendix hereto, the opinion of the Supreme Court of Pennsylvania in the instant case; its opinion in the case of *Commonwealth* v. *Ford Motor Co.*, 350 Pa. 236, 38 A (2d) 329, which was rendered on the same date and to which it referred in the instant case; and its opinion in the case of *Commonwealth* v. *Columbia Gas & Electric Corp.*, 336 Pa. 209, 8 A (2d) 404, upon which it relied in both cases.

Conclusion

We therefore respectfully submit; that the questions arising in this case under the Constitution of the United States are substantial; that the decision of the Supreme Court of Pennsylvania affirming the decision of the Common Pleas Court of Dauphin County, Pennsylvania, should be reversed; and that an appeal should be allowed in order that this may be done.

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December 20, 1944.

No. 86

AN ACT

To further amend sections twenty and twenty-one of the act, approved the first day of June, one thousand eight hundred and eighty-nine (Pamphlet Laws, four hundred twenty), entitled "A further supplement to an act, entitled 'An act to provide revenue by taxation,' approved the seventh day of June, Anno Domini one thousand eight hundred and seventy-nine," by substituting a franchise tax on foreign corporations in lieu of the capital stock tax on such corporations; imposing a tax for a limited period upon that portion of the capital stock of certain corporations, joint-stock associations, limited partnerships, and companies which were heretofore exempt; increasing the rate of tax on the capital stock of fire and marine insurance companies; and making an appropriation.

Taxation.

Sections 20 and 21, of June 1, 1889 (P. L. 420), as last amended by act of April 25, 1929 (P. L. 657), further amended.

Section 1. Be it enacted, &c., That sections twenty and twenty-one of the act, approved the first day of June, one thousand eight hundred and eighty-nine (Pamphlet Laws, four hundred twenty), entitled "A further supplement to an act, entitled 'An act to provide revenue by taxation,' approved the seventh day of June, Anno Domini one thousand eight hundred and seventy-nine," as last amended by the act, approved the twenty-fifth day of April, one thousand nine hundred and twenty-nine (Pamphlet Laws, six hundred fifty-seven), are hereby further amended to read as follows:

Officers of certain corporations to make annual reports to Department of Revenue.

Section 20. That hereafter, except in the case of corporations of the first class and cooperative agricultural associations not having capital stock and not conducted for profit, banks, savings institutions, title insurance, or trust companies, building and loan associations, and foreign insurance companies, it shall be the duty of the president, vice-president, secretary, or treasurer of every corporation having capital stock, every joint-stock association, limited partnership, and every company whatsoever, now or hereafter organized or incorporated by or under any laws of this Commonwealth, and of every corporation, joint-stock association, limited partnership, and company whatsoever, now or hereafter incorporated or organized by or under the law of any other State or Territory of the United States, or by the United States, or by any foreign government, and doing business in and liable to taxation within this Commonwealth, or having capital or property employed or used in this Commonwealth by or in the name of any limited partnership or joint-stock association, company, or corporation whatsoever, association or associations, copartnership or copartnerships, person or persons, or in any other manner, to make annually on or before the fifteenth day of March, for the calendar year next preceding, a report in writing to the Department of Revenue on a form or forms to be prescribed and furnished by

When report must be filed.

it. [stating specifically] *Such report shall, in addition to any other information required by the Department of Revenue, set forth:*

Contents of report.

First. The amount of its capital stock at the close of the year for which report is made, together with the highest selling price per share, and the average selling price thereof during said year.

Second. Its debt account.

Third. Its income account, together with the disposition of any net income, and its profit and loss statement.

Fourth. Its general balance sheet.

Fifth. Its real estate and tangible personal property, if any, owned and permanently located outside of the Commonwealth, and value of the same; and the value of the property, if any, exempt from taxation.

Sixth. [The proportion of its capital stock invested in and actually and exclusively employed and used in manufacturing within the Commonwealth during the year for which report is made.]

[Seventh.] A valuation and appraisal, in the manner hereinafter provided, of the capital stock of the said corporation, company, joint-stock association, or limited partnership, at its actual value in cash as it existed at the close of the year for which the report is made.

Affidavit of officers.

The affidavit of two of the officers of such corporation, limited partnership, joint-stock association or company, shall be attached to said report. Such affidavit shall be in the form required by the Department of Revenue, but shall state, in addition to any other averments required by the department, that, with fidelity and according to the best of their knowledge and belief, the affiants have estimated, valued and appraised, as shown in said report, the capital stock of the said corporation at its actual value in cash as it existed at the close of the year for which report is made; not less, however, than, first, the average which said stock sold for during the year; and second, not less than the price or value indicated or measured by net earnings or by the amount of profit made and either declared in dividends, expended in betterments, or carried into the surplus or sinking fund; and third, not less than the actual value indicated or measured by consideration of the intrinsic value of its tangible property and assets, and of the value of its good will and franchises and privileges, as indicated by the material results of their exercise, taking also into consideration the amount of its indebtedness.

Determination of actual value of capital stock.

Procedure.

The time for filing reports may be extended; taxpayers may be permitted to file their reports on a fiscal year basis; the procedure in case the Department of Revenue is not satisfied with the appraisement made by

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the officers of the taxpayer, and the penalties for failing to file reports and pay taxes shall be as prescribed by law.

Tax of five mills on capital stock of domestic corporation, etc.

Section 21. *(a)* That every *domestic* corporation, other than corporations of the first class and cooperative agricultural associations not having capital stock and not conducted for profit, and every joint-stock association, limited partnership, and company whatsoever, from which a report is required under the twentieth section hereof, shall be subject to, and pay into the Treasury of the Commonwealth annually, through the Department of Revenue, a tax at the rate of five mills upon each dollar of the actual value of its whole capital stock of all kinds, including common, special, and preferred, as ascertained in the manner prescribed in said twentieth section. [and it]

Tax of five mills on capital stock of foreign corporation, etc.

(b) Every foreign corporation, joint-stock association, limited partnership, and company whatsoever, from which a report is required under the twentieth section hereof, shall be subject to and pay into the treasury of the Commonwealth annually, through the Department of Revenue, a franchise tax at the rate of five mills upon a taxable value to be determined in the following manner:

The actual value of whole capital stock shall be divided into 3 equal parts.

The actual value of its whole capital stock of all kinds, including common, special, and preferred, shall be ascertained in the manner prescribed in the twentieth section of this act, and shall then be divided into three equal parts.

(1) Of one third, such portion shall be attributed to business carried on within the Commonwealth, as shall be found by multiplying said third by a fraction, whose numerator is the value of the taxpayer's tangible property situated within the Commonwealth, and whose denominator is the value of all the taxpayer's tangible property wherever situated.

(2) Of another third, such portion shall be attributed to business carried on within the Commonwealth, as shall be found by multiplying said third by a fraction, whose numerator is the expenditures of the taxpayer for wages, salaries, commissions, or other compensation to its employes, and assignable to this Commonwealth as hereinafter provided, and whose denominator is the total expenditures of the taxpayer for wages, salaries, commissions, or other compensation to all its employes.

(3) Of the remaining third, such portion shall be attributed to business carried on within the Commonwealth, as shall be found by multiplying said third by a fraction, whose numerator is the amount of the taxpayer's gross receipts from business assignable to this Commonwealth as hereinafter provided, and whose denominator is the amount of the taxpayer's gross receipts from all its business.

Taxable value.

The sum of the amounts, determined in accordance with the foregoing three rules, shall be the taxable value.

Where only two of the rules are applicable.

In a case where only two of the foregoing three rules are applicable, the remaining third equal part of the value of the entire capital stock shall be divided into two equal parts, each of which shall be apportioned in accordance with one of the remaining two rules. If only one of the three rules is applicable, that part of the entire capital stock attributed to business carried on within the Commonwealth shall be determined solely by that rule.

If only one rule is applicable.

Amount assignable to the Commonwealth of expenses of taxpayer for wages, etc.

The amount assignable to this Commonwealth of expenditures of the taxpayer for wages, salaries, commissions, or other compensation to its employes, shall be such expenditures for the taxable year as represent the wages, salaries, commissions, or other compensation of employes not chiefly situated at, connected with, or sent out from premises for the transaction of business owned or rented by the taxpayer outside the Commonwealth.

Amount of gross receipts from business assignable to the Commonwealth.

The amount of the taxpayer's gross receipts from business assignable to this Commonwealth shall be the amount of its gross receipts for the taxable year from, (1) sales, except those negotiated or effected in behalf of the taxpayer by agents or agencies chiefly situated at, connected with, or sent out from premises for the transaction of business owned or rented by the taxpayer outside the Commonwealth, and sales otherwise determined, by the Department of Revenue, to be attributable to the business conducted on such premises, and (2) rentals or royalties from property situated or from the use of patents within this Commonwealth. If a taxpayer maintains an office, warehouse, or other place of business in a state other than this Commonwealth for the purpose of reducing its tax under this subsection, the Department of Revenue shall, in determining the amount of its gross receipts from business assignable to this Commonwealth, include therein the gross receipts from sales attributed by the taxpayer to the business conducted at such place of business in another state.

If a taxpayer maintains office, etc., outside of State to reduce the amount of tax.

Application of a rule.

A rule shall not be deemed to be inapplicable merely because all the tangible property or the expenditures of a taxpayer for wages, salaries, commissions, or other compensation, or the gross receipts of the taxpayer are found to be situated, incurred, or received without the Commonwealth.

(c) It shall be the duty of the treasurer or other officers having charge of any such corporation, joint-stock association, or limited partnership, upon which a tax is imposed by this section, to transmit the amount of said tax to the treasury of the Commonwealth within the time prescribed by law for the payment of State taxes settled by the Department of Revenue: Provided,

Proviso.

That for the purposes of this act, interest in limited partnerships or joint-stock associations shall be deemed to be capital stock, and taxable accordingly: Provided also, That corporations, limited partnerships, and joint-stock associations, liable to a tax [on capital stock] under this section, shall not be required to pay any further tax on the mortgages, bonds, and other securities owned by them and in which the whole body of stockholders or members, as such, have the entire equitable interest in remainder; but corporations, limited partnerships, and joint-stock associations, owning or holding such securities as trustees, executors, administrators, guardians, or in any other manner than for the whole body of stockholders or members thereof as sole equitable owners in remainder, shall return and pay the tax imposed by this act upon all securities so owned or held by them, as in the case of individuals: [And provided] *Provided further, That the* [provisions of this section] *tax of five mills, imposed by this section on reports filed for the calendar years one thousand nine hundred and thirty-five and one thousand nine hundred and thirty-six, or for the fiscal years beginning in the calendar years one thousands nine hundred and thirty-five and one thousand nine hundred and thirty-six,* shall [not] apply to the taxation of the capital stock of corporations, limited partnerships, and joint-stock associations, organized for laundering, for the processing and curing of meats, their products and by-products, [or] *and* for manufacturing purposes, *excepting companies engaged in the distilling of liquors: Provided further, That after said two year period, the provisions of this section shall not apply to the taxation of the capital stock of corporations, limited partnerships, and joint-stock associations, organized for laundering, for the processing and curing of meats, their products and by-products, or for manufacturing purposes,* which is invested in and actually and exclusively employed in, carrying on laundering, the processing and curing of meats, their products and by-products, or manufacturing within the State, excepting companies engaged in the [brewing or] distilling of [spirits or malt] liquors, and such as enjoy and exercise the right of eminent domain; but every corporation, limited partnership, or joint-stock association organized for the purpose of laundering, or processing and curing meats, their products and by-products, or manufacturing, shall pay the State tax of five mills herein provided, upon such proportion of its capital stock, if any, as may be invested in any property or business not strictly incident or appurtenant to the laundering or manufacturing business, or the business of processing and curing meats, their products and by-products, in addition to the local taxes assessed upon its property in the district

Proviso.

Securities exempt from the tax.

Securities held in trust.

Proviso.

Certain corporations exempt.

where located; it being the object of this proviso to relieve from State taxation only so much of the capital stock as is invested purely in the laundering or manufacturing plant and business, or the plant and business used in the processing and curing of meats, their products and by-products: Provided further, In case of fire and marine insurance companies, the tax imposed by this section shall be at the rate of [three] *five* mills upon each dollar of the actual value of the whole capital stock: Provided, That nothing in this act shall be so construed as to apply to building and loan associations chartered by the State of Pennsylvania.

Proviso.

Proviso.

Constitutional clause.

Section 2. If this act is declared unconstitutional by a final judgment, order, or decree of a court of competent jurisdiction, all the provisions of section twenty-one of the act, amended by this act, pertaining to the taxation of the capital stock of foreign corporations, which were made inapplicable and inoperative thereto by this amendment, shall thereupon become operative and applicable in respect to such corporations, from the effective date of this act, and such corporations shall for that period and thereafter be taxed to the same extent and in the same manner, as if this amendment had not been enacted. In such event any taxes, which were settled under this act, shall, to the extent that such taxes have been paid and are unrefunded, be credited against the taxes settled and imposed for the same period, under the provisions of said section twenty-one, which are again made operative and applicable to foreign corporations by this section: Provided, That, if such credit exceeds the taxes due, the excess may be refunded upon application being made to the Board of Finance and Revenue in the manner prescribed by law.

Proviso.

Act to be retroactive.

Section 3. The provisions of this act shall be retroactive to the first day of January, one thousand nine hundred thirty-five, so that capital stock of domestic corporation, limited partnerships, and joint-stock associations, organized for laundering, for the processing and curing of meats, their products and by-products, and for manufacturing purposes, shall pay the tax imposed for the calendar years one thousand nine hundred thirty-five and one thousand nine hundred thirty-six, or for the fiscal years, beginning in the calendar years one thousand nine hundred and thirty-five and one thousand nine hundred and thirty-six in the same fashion as other corporations, limited partnerships, and joint-stock associations.

When effective.

Section 4. This act shall become effective immediately upon its final enactment, and its provisions shall be applicable to the settlements of franchise taxes on foreign corporations for the year ending the thirty-first day of December, one thousand nine hundred and thirty-

five, or any fiscal years ending in the calendar year one thousand nine hundred and thirty-six.

Section 5. The sum of eighteen million dollars ($18,000,000), derived from the tax imposed under the provisions of this act on reports filed for the year one thousand nine hundred and thirty-five, shall be used only for unemployment relief and for such purposes is hereby appropriated. Unemployment relief.

APPROVED—The 16th day of May, A. D. 1935.

GEORGE H. EARLE

The foregoing is a true and correct copy of Act of the General Assembly No. 86.

Edna L. Lawrence

Secretary of the Commonwealth.

APPENDIX "B"

[186]

IN THE SUPREME COURT OF PENNSYLVANIA, MIDDLE DISTRICT

May Term, 1943

No. 24

COMMONWEALTH OF PENNSYLVANIA

v.

THE QUAKER OATS COMPANY, Appellant,

May Term, 1943

No. 25

COMMONWEALTH OF PENNSYLVANIA, Appellant

v.

THE QUAKER OATS COMPANY

Appeals from Final Judgment of the Court of Common Pleas of Dauphin County in No. 506 Commonwealth Docket, 1938.

Opinion of the Court

ALLEN M. STEARNE, J.

These appeals, like the appeal in *Commonwealth v. Ford Motor Company* (opinion this day filed), are from the judgment of the court below affirming, with some modifications, the resettlement by the Department of Revenue of the franchise tax of a foreign corporation. As in that case, appellant contends first that the Commonwealth erred in applying the statutory formula of the Act of May 16, 1935, P. L. 184, 72 PS 1901, and secondly, that, if applied correctly, the formula results in unconstitutional taxation. It

is unnecessary to repeat here the observations made in the *Ford Motor Company* case concerning the purpose, structure and operation of the Act of 1935, nor to reiterate at any length our opinions there expressed regarding the incidence and constitutionality of the franchise tax, generally. We will, however, review in some detail the facts of appellant's case and its contentions that the tax imposed upon it violates the statute and appellant's constitutional rights.

The Quaker Oats Company was incorporated under the laws of New Jersey to manufacture and deal in cereals and cereal products. In 1933 it received a Certificate of Authority to transact in this Commonwealth the business of "selling and dealing in cereals and cereal products." In the tax year involved in this appeal, 1935, appellant's principal office was in Chicago, Illinois. It was engaged in the purchase, storing and manufacturing of cereal and cereal products, employing for these purposes land, buildings, grain, elevators, railroad equipment, machinery, mills and other tangible property located outside of Pennsylvania. It controlled and owned all, or a majority, of the shares of fifteen subsidiary companies, including a hydraulic power corporation which supplied power to the parent company for manufacturing purposes, and several companies domiciled in Europe and South America. Three of these subsidiaries were inactive in 1935. Throughout the United States and abroad it maintained a vast selling enterprise for the marketing of its own products and the products of its subsidiaries. The total value of its assets was $60,821,913, including working capital of $14,901,015 in United States Government securities, and $1,117,545 in state, county, and municipal obligations, used in the purchase of raw cereals.

In this State appellant had two sales offices, one at Pittsburgh and the other at Philadelphia. Here orders were taken by its salesmen for flour, corn meal, animal and poultry foods, breakfast foods and other cereal products, some of which were sold in packages and some in bulk. A local inventory of goods, insufficient to supply all orders originating in Pennsylvania, was stored here in public warehouses. Other tangible property included automobiles used by the salesmen, and office furniture and equipment. The

total value of appellant's tangibles in this Commonwealth was $22,440. None of the subsidiary corporations transacted any business in Pennsylvania or owned any tangible property here. The Pennsylvania payroll of appellant was $143,259. Of its total gross receipts of $66,067,332, *more than one-tenth,* or $7,224,347, was assigned by the court below to Pennsylvania. Bank accounts were maintained at Pittsburgh and Philadelphia.

Upon the basis of appellant's report, the franchise tax for 1935 was settled at $4,655, which was subsequently revised to $28,645. Appellant obtained a review whereupon the tax was resettled at $16,495. On appeal from the resettlement, the court below excluded from the value of the capital stock in the formula the sum of $114,196 which represented the value of the stock of the inactive subsidiaries, thereby reducing the multiplicand. However, the numerators of the three allocative fractions were increased, with the result that, on the final determination, the tax was increased to $16,637.

Appellant contends, as did the appellant in the *Ford Motor Company* case, that it is a *multiform* enterprise. It has attempted to segregate its activities into three functions, which, it maintains, are unrelated, namely: (1) the purchase and storage of grains, (2) the manufacture of cereals and cereal products, and (3) selling and dealing in cereal products. As only the last of these functions is carried on in this State, appellant asserts that the value of capital stock employed in the first two functions should be excluded from the multiplicand. Actually, however, the record indicates that such segregation of functions is entirely artificial, and that appellant is engaged in an unitary enterprise. In its proof, appellant did not even attempt to segregate the wages, tangible property and gross receipts of the three "unrelated" functions, so that there is, on this record, no factual basis for a revision of the allocative fractions in the formula. Appellant's estimate of capital employed exclusively in the "selling and dealing" function, derived from its corporate balance sheet, is conceded to represent assets "which were, *or a part of which may have been,* employed in selling." Its witnesses testified that the production and sale of packaged goods and

goods in bulk by the company were inter-related, that they enjoyed a common source of supply, that the national advertising and goodwill of the whole enterprise affected sales in Pennsylvania, that the corporate revenues were derived from the ultimate sale of the products resulting from the purchases and manufacturing. Obviously, the purchasing, storing and manufacturing processes of appellant were not complete and distinct corporate activities, or businesses. They were not self-sustaining or an end in themselves. They were conducted in aid of the selling activities, with which they are interlocked and integrated. The entire enterprise is unitary in purpose and result. This is not a situation like that referred to in *Adams Express Co.* v. *Ohio,* 165 U. S. 194, or that before us in *Commonwealth* v. *Columbia Gas and Electric Corp.,* 336 Pa. 209, 8 A. 2d 404, in which a corporation conducts diverse forms of business having no unity save unity of ownership, and no common relation save by separate contributions to the total revenue of the corporation. This is a true unitary enterprise, having its inception in the purchase, storing, and manufacture of cereals and cereal products, and its consummation in their sale. The court below has so found, and as the record sustains the finding, it is conclusive upon us.

We have, in the *Ford Motor Company* case, rejected the contention, made also by this appellant, that the formula employed by the legislature in Section 21 (b) of the Act of 1935 to evaluate the franchise of a foreign corporation doing business here is inherently arbitrary and unreasonable, and that it results in taxing property and business outside of this State. We have also rejected the arguments, advanced again in this appeal, that the tax on the franchise of foreign corporations imposed by the Act of 1935 is a property tax; that it violates the equal protection clause of the Federal Constitution, and our Constitution, by discriminating against foreign corporations in favor of domestic corporations; that it is not uniformly imposed on corporations in the same classification, and that it contravenes the clauses of the Federal and State constitutions prohibiting the impairment of the obligations of contracts

and the taking of property without due process of law. No purpose would be served by repeating here what we said in that case.

Appellant has failed to prove, with respect to its specific tax, that any of these constitutional provisions has been violated. The court below found that all of the corporate assets were, with the exception of its investments in the stock of three inactive subsidiaries, actively used in the unitary enterprise of appellant, and that their use affected the value of the Pennsylvania franchise. The tax is not imposed *upon* any of this property, but upon the value of the Pennsylvania franchise, *measured* by the capital stock related to the business activity of appellant in this State. The right of the State to use such a measure to reasonably determine the enhancement of the value of the local franchise by the employment of extraterritorial property is fully discussed in the *Ford Motor Company* case, and need not be here reviewed.

Nor is it necessary to devote additional discussion to appellant's contention that the tax falls upon exempt Federal, State and municipal securities. The court below has found, and appellant concedes, that these securities "were employed or held as a reserve by [appellant] in its purchasing business." As the purchasing function was related by integration to the selling function, and as it affected the value of appellant's franchise in Pennsylvania, the inclusion of these securities in the formula producing the tax base was proper. They, themselves, were not taxed.

A considerable portion of appellant's argument is directed to alleged error in the composition of the gross receipts fraction of the formula. The Commonwealth and the court below used, as the numerator, the total amount of sales originating in, and attributable to the two sales agencies operated in this State by appellant. Appellant contends that there should have been excluded all sales negotiated by salesmen of the Pennsylvania agencies but consummated by the approval of the home office. Section 21 (b) of the Act provides: "The amount of the taxpayer's gross receipts from business assignable to this Commonwealth shall be the amount of its gross receipts for the

taxable year from, (1) sales, *except those negotiated or effected in behalf of the taxpayer by agents or agencies chiefly situated at, connected with, or sent out from premises for the transaction of business owned or rented by the taxpayer outside the Commonwealth* • • •."

Appellant would have us construe this to mean that sales attributable to Pennsylvania must be only those which are both *negotiated and effected* within the State, using "effected" in the sense of *consummated*, or *completed*. Such a construction would, of course, enable this appellant, or any foreign corporation, to eliminate the third allocative fraction from the tax formula by so arranging its sales machinery that all contracts would be "accepted," and therefore consummated, at the home office. This is clearly contrary to the intention of the legislature, which was that the gross receipts fraction should reflect that portion of *corporate activity* conducted in this State resulting in gross receipts to the corporation in the form of sales, rents and royalties. To assign to the word "effected" the meaning urged upon us by appellant would controvert and frustrate the legislative purpose. "Effected" has no technical meaning as a legal word of art. It is used in different senses, and often, loosely in contracts and statutes. Here, it is clear that it was intended to mean "accomplished" or "brought about": See Webster's New International Dictionary (unabridged). Given that meaning, it is consistent with the context and purpose of the section. The case of *Commonwealth* v. *Continental Rubber Works*, 347 Pa. 514, cited by appellant, supports this construction and opposes the construction for which appellant contends. There we held that sales negotiated by a branch sales office in New York, but *approved* and *accepted* in Pennsylvania, were assignable *outside* of Pennsylvania under Section 21 (b) above quoted. While it is true that the legislature excepted sales negotiated *or* effected outside of Pennsylvania, it is clear that it would not have intended the inclusion in the fraction of only those sales which were *both* negotiated and technically completed in this State, or by salesmen operating from agencies in this State.

Even if the Act were not so construed, it appears that many of appellant's sales were concluded in Pennsylvania. In the case of orders for bulk goods, for example, a written contract of sale was executed *in Pennsylvania* after approval of the home office in Chicago was obtained. Orders for packaged goods were received in the Pennsylvania offices and the sale was consummated there if no disapproval was received from Chicago within two days. Even if these sales are considered to be consummated in Chicago by an implied acceptance, appellant has not offered any proof of the segregated amount of such sales. The burden was upon it, on appeal to the court below from the resettlement of the tax, to show the error of the Commonwealth's computation.

Appellant's final argument is, that if Section 21 (b) is to be construed to include in the gross receipts formula sales consummated outside the Commonwealth or made in interstate commerce, that this tax violates the commerce clause of the Federal Constitution and imposes an unreasonable burden on interstate commerce. In this connection, appellant again conveniently overlooks the fact that the tax is imposed upon the privilege of doing business here, measured by capital stock. It is in no sense a tax on sales or on interstate transactions. Sales enter into the determination of the tax only as an index of business activity in this State. They are merely a factor in one of three allocative fractions designed to reflect such activity. There is no question, therefore, of taxing sales here or elsewhere. Appellant is not engaged in interstate commerce alone, and is not being taxed here for the privilege of doing an interstate business. The fact that its interstate business and its property in other jurisdictions enter into the computation of the tax because they affect the value of the Pennsylvania franchise does not make the tax, ipso facto, an unreasonable burden on interstate commerce in violation of the commerce clause. The burden imposed by the Act of 1935 is incidental and reasonable. As stated by Mr. Justice Stone, now Chief Justice, in *International Shoe Co.* v. *Shartel,* 279 U. S. 429: "A franchise tax imposed on

a corporation, foreign or domestic, for the privilege of doing a local business, if apportioned to *business done* or property owned *within* the state, is not invalid * * * because a part of the property or capital included in *computing* the tax is used by it in interstate commerce." See also *St. Louis S. W. Ry. Co.* v. *Arkansas*, 235 U. S. 350; *Hump Hairpin Co.* v. *Emmerson*, 258 U. S. 290. And in *Southern Realty Corp.* v. *McCalum*, 65 F. (2d) 934, certiorari denied 290 U. S. 692, it was stated, "The origin, form, and location of that capital, whether in or out of the state, is unimportant, provided it is to contribute to the corporation's business power within the state * * * That a state may impose such a franchise or business privilege tax, and may measure it by the capital stock and surplus used by the corporation in its business, or by its income therefrom, although business is done in more states than one, without unconstitutional interference with interstate commerce or other Federal prerogative, and without a taxing of property beyond the jurisdiction of the taxing state, when the capital by which the tax is measured is reasonably apportioned according to the business there done, is settled by many decisions."

The judgment of the court below is affirmed; costs to be paid by appellant.

Certified a True Copy.

(S.) Helen W. Speck,
Deputy Prothonotary.

APPENDIX "C"

IN THE SUPREME COURT OF PENNSYLVANIA, MIDDLE DISTRICT, MAY TERM 1943

No. 12

COMMONWEALTH OF PENNSYLVANIA

v.

FORD MOTOR COMPANY, *Appellant*

Appeal from Final Judgment of the Court of Common Pleas of Dauphin County in No. 416 Commonwealth Docket, 1939.

Opinion of the Court

Filed Jun. 30, 1944.

ALLEN M. STEARNE, *J.*

The appeal is from the judgment of the court below affirming the resettlement of a foreign corporation's franchise tax by the Department of Revenue.

The primary question involved is whether the formula enacted by the Act of May 16, 1935 P. L. 184, 72 PS 1901, amending the Act of June 1, 1889 P. L. 420, interpreted by this Court in *Columbia Gas and Electric Corp.*, 336 Pa. 209, 8 A. 2d 404, was correctly applied. The second question presented is whether, if correctly applied, the provisions of the Act are constitutional.

It will suffice preliminarily to state that the Act imposes a franchise or excise tax upon foreign corporations authorized to do business in this Commonwealth, in substitution for the property or ad valorem tax theretofore payable by such corporations. In the *Columbia Gas and Electric Corp.* case, supra, the history of the legislation is discussed and the constitutionality of the Act sustained. We decided, however, that assets of such foreign corporations which were not part of the working capital, and had no relation to the value of the business carried on in this Common-

wealth, should be excluded from the operation of the formula. See *Commonwealth* v. *The Mundy Corp.*, 346 Pa. 482, 30 A. 2d 878.

It is earnestly urged by appellant that the record reveals that there have been included in the application of the formula, tangible and intangible assets which are not part of its capital and which bear no relation to the value of the business carried on within this Commonwealth. In support of such contention we have been supplied with graphs, charts and mathematical demonstrations of almost astronomical proportions. We are therefore required to examine the facts in some detail to determine whether the statute has been correctly applied to them.

The Ford Motor Company is a corporation organized under the laws of Delaware. It is authorized by its charter to engage in a variety of business activities including the purchase, sale and holding of securities for investment or otherwise, the acquisition, management and operation of subsidiary corporations, the acquisition, ownership and granting of licenses under patents, mining, processing and dealing in coal, minerals, ores and metals, and the manufacture and sale of goods and merchandise of every description. Appellant's principal place of business is at Dearborn, Michigan. It has scattered throughout the United States a vast network of industrial and mercantile operations. It owns and operates mines of coal, iron, lead and garnet. It owns and operates quarries and timber tracts. Its manufactories produce pig iron, steel, castings, coke, benzol, gas and coal tar products. It has rolling mills, forges, die and tool shops, glass factories, paint plants, cement plants and saw mills. It operates a private railroad and a fleet of vessels plying the inland waters and the oceans.

In the State of Pennsylvania, in 1935, appellant owned and operated an assembly plant at Chester, where parts shipped from outside the State were used in the final step of manufacuring Ford automobiles. At Chester there was also a sales and service depot from which Ford automobiles and parts are sold at wholesale to dealers. At Pittsburgh there was a similar sales and service depot. In Philadelphia there was a building used for storage and the display of appellant's products. The Pennsylvania payroll of the cor-

poration for that year was in excess of $4,625,125, the book value of its tangible assets in this State was $7,196,685, and its gross receipts assignable to Pennsylvania operations were $45,927,254. These figures were reported by appellant to the Department of Revenue and used by the taxing authorities.

As a foreign corporation doing business in this State, appellant was authorized by its Certificate of Authority from the Commonwealth to engage here in the business of manufacturing and selling automobiles. For the privilege of doing this business, it was subject to the payment of an annual franchise tax under the Act of May 16, 1935, P. L. 184, 72 PS 1901, amending the Act of June 1, 1889, P. L. 420. Upon the basis of the company's report, the tax for 1935 was originally assessed at $106,499.91. Appellant petitioned for resettlement, and obtained a reduction of the tax to $88,470.92.

To comprehend appellant's contentions it is necessary first to refer to the purpose and operation of the Act of 1935. This Act imposes a *franchise* or *excise* tax upon foreign corporations, as distinguished from a property or ad valorem tax. Prior to 1935, foreign corporations doing business here were required to pay a capital stock tax, which, as a property tax, proved unsatisfactory and produced unfair results. As we stated in *Arrott's Estate*, 322 Pa. 367, 372, 185 A, 697, the Act of 1935, by changing the incidence of the foreign corporation tax, endeavored to achieve a more equitable measurement of taxation for this class of corporation. It accomplished this by imposing a franchise tax not *upon* capital stock but *measured* by capital stock. The tax base was determined, not by the allocation to Pennsylvania of an arbitrary percentage of the total capital stock of the corporation, but, through the use of a tripartite formula, by ascertaining, insofar as possible, the relation of the corporate activities in this State to the activities of the corporation everywhere. In the *Columbia Gas and Electric Corp.* case, supra, at page 216, we said: "The tax base represents the value of the right to do business in this State." This value, of course, is intangible, and incapable of *exact* computation, but, in

the *Columbia Gas and Electric Corp.* case, supra, we discussed the measurement of value devised by the legislature and sustained its reasonableness.

The Act of 1935 provided that the entire capital stock of a foreign corporation, as its proper valuation, should be divided into three equal parts. The resulting figure may be referred to, for convenience, as the multiplicand. This is first multiplied by the decimal fraction representing the ratio of tangible property in this State to tangible property of the corporation everywhere. It is then to be multiplied by a decimal fraction representing the ratio of wages paid by the corporation in this State to the total of its wage payments everywhere. Finally, it is multiplied by the decimal fraction representing the ratio of gross receipts assignable to Pennsylvania to gross receipts from all sources. The sum of these three multiplications is the tax base, representing the value of the Pennsylvania franchise, which is taxed at the rate of five mills.

In the *Columbia Gas and Electric Corp.* case, supra, we held that the tax, not being a property tax, but a tax upon the privilege of engaging in business in this Commonwealth, should be measured by a valuation reflecting capital so used as to affect the value of the Pennsylvania franchise, rather than a valuation reflecting merely aggregate capitalization. Many foreign corporations, like this appellant, are chartered to engage in a number of *unrelated* business activities or functions. Some of these diverse functions may have no relation to the business conducted in this State. We found that the Columbia Gas and Electric Corporation was engaged elsewhere in an extensive holding company business, which had no effect upon the operating business conducted by it in Pennsylvania, and, therefore, no effect upon the value of its Pennsylvania franchise. Consequently, we held that it was consistent with the legislative intention to exclude from the multiplicand of the statutory formula the value of so much of the capital stock of the corporation as was devoted to the holding company business. So reduced, the multiplicand merely reflected the value of the corporation's capital employed here, and elsewhere, in its operating function, since

only the employment of this capital was the value of the Pennsylvania franchise enhanced or affected.

A similar result was reached in *Commonwealth* v. *The Mundy Corp.*, supra. In that case, we directed the exclusion from the formula of the value of securities owned by the corporations, which had been purchased with shareholders' contributions and were retained solely for investment. We held that these assets were not part of the *working capital* of the corporation, and had no relation to the value of the business carried on by the corporation in this State.

Relying on these two decisions, appellant first contends that the determination of its 1935 tax is contrary to the established principles of operation of the Act of 1935. It asserts that its business is *multiform*, and that it conducts in Pennsylvania only two of four distinct corporate functions. It attempts to segregate these functions as follows: (1) the purchase and production of raw materials, (2) the manufacture of steel, glass, cement, paint, forgings, tools, dies, gauges, coke, benzol, and other products and byproducts of its raw materials, including finished automobile parts; (3) the assembly of finished automobiles, ready for sale, from pre-fabricated parts, and (4) the sale and servicing of the finished automobive products. Only the latter two functions are, it asserts, conducted in this State. Upon this premise, appellant maintains that all of the capital stock valuation representing capital employed in the first two functions should be withdrawn from the statutory formula. Thus, instead of using as the multiplicand one-third of $498,428,150, which the court below found to be the entire value of appellant's capital stock, appellant would substitute a multiplicand of one-third of $90,396,002, which it contends the value of that portion of the entire capital stock which is devoted to the last two functions above mentioned.

The fallacy of appellant's major premise is apparent. It appears to be extremely arbitrary to divide its manufacturing operation into three distinct and "unrelated" functions, segregating, for instance the function of assembly, which appellant concedes to be the last phase or final

step in the process of manufacture, from the first and intermediate phases. The chief difficulty with appellant's premise is, however, that it is completely contrary to the evidence presented and to the findings of fact of the court below, which, being supported by the record, must be given their customary conclusive effect.

The court below found that all of the capital stock of appellant was properly included in the measurement of its franchise tax, because it was all employed by the corporation in conducting a *unitary* enterprise. The entire capital of the Ford Motor Company is devoted to the manufacture and sale of its automotive products. There is an integral coordination of its various functions from the very inception of the manufacturing process to the sale and servicing of the finished products. The fact that these functions are many and varied does not require that they be regarded, for tax purposes, if not for practical purposes, as separate and unrelated enterprises. On the contrary, it appears that appellant has drawn them together into a cohesive economic unit. Because it finances its own purchases of raw materials, thereby reducing the cost, it must preserve large resources of working capital. It produces a large percentage of these materials at its own mines, quarries and timber lands. It maintains a private system of transportation for transporting the raw materials to its mills and factories. It processes them and manufactures them into parts for its trucks and automobiles. The parts fabricated by the company are shipped to assembly plants throughout the nation, similar to the plant at Chester, Pennsylvania, where the final step in the manufacturing process takes place. By means of these plants the company is enabled more conveniently, as its witness testified, to reduce the time and cost of distribution. In the assembly plants the parts are attached to the chassis, the body is welded, the upholstery is installed, the motor is assembled, the automobile is painted and equipped with tires and accessories. From Chester finished cars are shipped on order throughout Pennsylvania and many surrounding states. From the sale and servicing of the finished products the company derives its revenues.

This is the consummation of the *unified* operation. The whole of the corporate capital is devoted to the manufacture and sale of the finished products. The whole enterprise is like a vast assembly line, each part of which must operate in relation to the others and in harmony with them.

The fact that appellant's structure is vast and complex does not, as we have said, obscure its unitary nature. True, as appellant contends, one or more of the phases of its complete activity might have been separated from the others and conducted apart from them. The company could, for example, cease to produce its own raw products and purchase these materials from outside sources. It might have resorted to financial institutions for loans to purchase materials, thereby reducing its working capital. It might have ended the process of manufacture short of assembly, or, as appellant suggests, limited its activities to the assembly of automobiles from finished parts fabricated by other corporations. *It did, however, none of these things.* It has preferred to establish a great, cohesive empire of industry, through which it may control every phase and every step of the manufacture and sale of its products.

The tremendous advantage which has accrued to appellant by this integration of activities is manifest. The cost of the products in Pennsylvania has been affected by the economies possible in such a *unitary* structure. The demand for them has been affected by the goodwill of the large single enterprise, its centralized advertising possibilities, and its financial stability. Each one of the diversified activities of the corporation, representing together the full play of its enormous capitalization, bears directly or indirectly, and materially, upon the value of the Pennsylvania franchise. Obviously, the company cannot enjoy all of the practical advantages of an industrial unit, and, at the same time, attempt to deny for tax purposes the integration of the enterprise and the effect of that integration on its business activities in this State.

Our conclusion, and the conclusion of the court below, regarding the unity of appellant's enterprise is not novel. In *Ford Motor Company* v. *Clark*, 100 F. (2d) 515, it was held that this appellant is a *unitary* enterprise. The court states, at page 518: "*The Ford Motor Company has no*

business except the making and selling of cars.'' It is that business which appellant conducts in Pennsylvania. The decision last cited was affirmed by the Supreme Court of the United States in *Ford Motor Company* v. *Beauchamp*, 308 U. S. 331, in which Mr. Justice Reed said, at page 336; "In a *unitary* enterprise, property outside the state, when correlated in use with property within the state, *necessarily affects the worth of the privilege within the state.* Financial power inherent in the possession of assets may be applied, with flexibility, at whatever point within or without the state the managers of the business may determine * * *. The weight, in determining the value of the intrastate privilege, given the property beyond the state boundaries is but a recognition of the very real effect its existence has upon the *value of the privilege granted within the taxing state.''* See also *Ford Motor Co.* v. *Oklahoma Tax Commission*, 188 Okla. 78, 106 P. (2d) 803. Appellant's attempts to distinguish these cases do not detract from the conclusion therein that appellant's business is functionally *unitary*, and that its functional correlation affects materially the "value of the privilege granted within the state."

Appellant also urges that the court below and the Commonwealth erred in the application of the statutory formula by including in the multiplicand the book value of the stock of wholly-owned subsidiaries without including in the denominators of the allocative fractions the tangible property, wages and gross receipts of those subsidiaries. In effect, appellant would have us disregard entirely the entity of these corporations merely because the book value of their stock has been included in the assets of the corporation and is, therefore, reflected in the value of its own capital stock. The court below found as a fact that all of the assets of the appellant company, including such stocks, bonds, and other securities, are part of its working capital. As appellant does not carry the operating expenses and receipts of these corporations on its own books, and does not include them in its report of wages and receipts, there is no basis for their inclusion in the formula in law or in fact. That portion of appellant's capital invested in these stocks is no less a part of its working capital because the stocks are wholly owned by appellant. We therefore conclude

that the Act of 1935, as interpreted by us in the *Columbia Gas and Electric* and *Mundy* cases, has not been violated by the Commonwealth's application of the formula in determining appellant's tax.

There remain for our consideration appellant's several contentions that the tax imposed violates the Federal and State constitutions. It is argued that the formula for measuring the base of the tax results in depriving appellant of its property without due process of law, in violation of the Fourteenth Amendment of the Federal Constitution, and is contrary to Article I, Section 9, of the State Constitution. This conclusion is predicated upon the assumption that the tax is a tax upon property, and that it falls upon property beyond the jurisdiction of the Commonwealth to tax, in the form of tax-exempt securities of the United States and tangible and intangible property having its situs in other states. We held in the *Columbia Gas and Electric Corp.* case, supra, that this is a franchise tax and not a property tax. This discussion need not be repeated. Nor is it necessary to labor the point that a franchise tax may be *measured* by property which would not, itself, be amenable to a property tax. In *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 165, it was said: "It is therefore well settled by the decisions of this Court that when the sovereign authority has exercised the right to tax a legitimate subject of taxation as an exercise of a franchise or privilege, it is no objection that the *measure* of taxation is found in the income produced in part from property which of itself considered is nontaxable." See also *National Leather Co.* v. *Massachusetts*, 277 U. S. 413. And, in *Educational Films Corp.* v. *Ward*, 282 U. S. 379, at page 389, Mr. Justice Stone, now Chief Justice, stated: "* * * it has held with like consistency that the privilege of exercising the corporate franchise is no less an appropriate object of taxation by one government merely because the corporate property or net income, which is made the *measure* of the tax, may chance to include the obligations of the other, or the income derived from them." Another case in point is *Philadelphia Contributionship* v. *Commonwealth*, 98 Pa. 48. As the reflection of the value of United States bonds owned by appellant in the measurement of the tax is not a tax upon

them, and is merely incidental to the operation of the formula, appellant's contention is not sound. The exclusion of the United States bonds from the measurement of the tax in the *Mundy* case, supra, was not upon constitutional grounds, but was directed because they did not form part of the working capital of the corporation taxed, and hence did not affect the value of the Pennsylvania franchise.

Appellant contends further, that, even if the tax in question is a franchise tax, the same sections of the Federal and State constitutions are violated by its imposition in the manner here approved, because the formula of measurement adopted by the legislature does not reasonably reflect the value of appellant's franchise, but results in an arbitrary allocation to this State of appellant's property in other jurisdictions. Appellant has endeavored to show, by estimates from its books, using its own "direct" method of allocation, and the "indirect method of allocation provided by the statutory formula, that the determination of its tax by the Commonwealth has this unconstitutional effect. Since this argument is based principally upon appellant's erroneous contention that it is a *multiform* enterprise, it requires nothing more than general discussion. Of appellant's "direct" method of determining the base for the franchise tax, it is sufficient to say that this method would not give proper weight in the value of the franchise to the advantages which it derives by its operation of a huge *unitary* enterprise. While we have conceded that an exact measurement of the value of a corporate franchise is impossible of attainment, we held in the *Columbia Gas and Electric Corp.* case, supra, that the method adopted by the legislature for this purpose in the Act of 1935 represented a reasonable and just attempt to determine that value. We there pointed out that the legislature had used in the formula three fractions which would reflect corporate activity in Pennsylvania in proper relation to the whole corporate activity. Chief Justice Kephart said, at page 220: "If the legislature had chosen to use a single one of these fractions and applied the same to the entire capital stock, certainly it could hardly be contended that it would be without its powers, provided proper consideration be given in each case to the elements to be included or omitted in

determining the value of the entire capital stock as the measure of the tax. The use of all three and the application of each to one-third of the entire capital stock value is simply an attempt to make the ultimate measure to which the tax is to be applied more representative of the actual worth of the franchise to do business and to allow the interplay of the factors to average out the hardship which might arise by reliance upon any single one."

Appellant's objection that there is no fraction representing the ratio of intangible property used in this state to intangible property everywhere, was also raised by the appellant in the *Columbia Gas and Electric Corp.* case, supra, and is adequately answered by the opinion. Clearly, the legislature is not bound to seek out and apply every possible permutation and combination of measurement that might have some bearing on the value of the franchise. In *Ford Motor Company* v. *Beauchamp,* supra, the United States Supreme Court sustained the formula of the Texas legislature which made the base of the franchise tax that proportion of capital stock, surplus and undivided profits, plus long term obligations, determined by the ratio of the gross receipts in the State to the total gross receipts of the corporation. This formula included only one of the three allocation fractions used in our statutory measure. In *Ford Motor Co.* v. *Oklahoma Tax Commission,* supra, the franchise tax formula of Oklahoma, also measured by capital stock, included only two of our three allocating fractions. See also *Southern Pacific Co.* v. *State Corporation Commission,* 41 N. M. 556, 72 P (2d) 15; *Roberts & Schaefer Co.* v. *Emmerson,* 271 U. S. 50; *International Shoe Co.* v. *Shartel,* 279 U. S. 429. The fact that the same allocating fractions are used in determining the base of the tax on net income of foreign corporations does not render them inappropriate for the determination of a franchise tax base measured by capital stock. Since they merely reflect *business activity* within the State they are equally appropriate to either determination. See *Butler Bros.* v. *McColgan,* 315 U. S. 501.

Appellant also contends that the Act of 1935, and the tax imposed upon it, violate the Fourteenth Amendment to the Federal Constitution by depriving it, and other foreign

corporations of the equal protection of the laws, and by discrimination in favor of domestic corporations. It is also maintained that Article IX, Section 1 of the Constitution of Pennsylvania, requiring taxes to be uniform upon the same class of subjects is violated. Despite the numerous authorities cited by appellant, it has failed utterly to sustain its charge of discrimination. Before the Act of 1935, both domestic and foreign corporations were subject to a capital stock tax. This was a tax upon *property*. Because of the unequal operation of the tax in the case of domestic and foreign corporations, the legislature adopted a franchise tax upon foreign corporations to achieve a greater degree of equality between the two classes. Equality of taxation does not require identical taxation. As we pointed out in the *Columbia Gas and Electric Corp.* case, supra, at page 227: "It is scarcely necessary to cite authorities that a state may differentiate in its method of taxing between foreign and domestic corporations." See *Kansas City &c. R. R. Co. v. Stiles,* 242 U. S. 111. Neither the Fourteenth Amendment nor Article IX, Section 1, of our Constitution, forbid classification justified by obvious differences in subjects of taxation. The incidence and base of taxation may be different in the case of foreign and domestic corporations. See *Pennsylvania Company, etc., Trustee, Case,* 345 Pa. 130, 135, 27 A. 2d 57.

The alleged discrimination in our tax laws against foreign corporations and in favor of domestic corporations is said to lie in the fact that domestic corporations enjoy certain exemptions in the computation of their tax base which are denied to foreign corporations. In this contention there is apparent again appellant's studied confusion of the essential differences between a property tax and a franchise tax. Certain property of domestic corporations, including United States obligations and tangible property having an extraterritorial location is excluded from the valuation of their capital stock for purposes of the direct tax. Obviously, this property could not constitutionally be included. Similar property, if owned by a foreign corporation and so employed by it as to affect the value of the franchise in Pennsylvania, is, on the other hand, included in the *measurement* of the base of the franchise tax. The

property itself is not taxed in the case of either domestic or foreign corporations. Such differences as result, result not from an intention of the legislature to discriminate against foreign corporations, but from the divergent natures of the taxes imposed on the two classes. See *Colgate v. Harvey*, 296 U. S. 404. The Commonwealth has demonstrated that a heavier tax burden falls more heavily on domestic corporations, by the capital stock tax, than falls upon foreign corporations subject to the payment of the franchise tax. In short, if appellant were a Pennsylvania corporation, it would pay more in capital stock taxes, utilizing the same property here, than it now pays in franchise taxes. While this demonstration does not afford an exact comparison (*Columbia Gas and Electric Corp.* case, page 159), it does lend strength to the Commonwealth's contention that there is a certain equivalence between the two forms of taxation despite the necessary differences in their application of which appellant complains.

The further contention of appellant that the statutory formula produces inequalities within the class of foreign corporations subject to the franchise tax is specious. Taking two hypothetical corporations, each of which is engaged in a *multiform*, rather than a unitary enterprise, it devotes an additional brief, replete with graphs, charts and mathematical assumptions, to proving that the corporation which, in this State, engages in a separate corporate function utilizing the greater amount of tangible property, would pay a higher tax, although both corporations, theoretically, had the same quantity of gross capital. If it were not for our decisions in the *Columbia Gas and Electric Corp.* and *Mundy* cases, supra, excluding from the measurement capital employed outside of the State in *unrelated* corporate functions. these interesting calculations might have some significance. It is sufficient to say, however, that neither of the hypothetical corporations would be taxed under the Act of 1935 by what appellant refers to as the "Commonwealth's Method", and that consequently, the inequality presumed by appellant would not arise. Appellant as a *unitary* enterprise, would not be affected, in any event, by the application of the formula in its suppositious cases.

Finally, appellant contends that the tax imposed by the Act of 1935 resulted in an impairment of its contract with the Commonwealth in violation of Article I, Section 10, of the Federal Constitution, and Article I, Section 17 of the Pennsylvania Constitution. This conclusion is predicated upon two assumptions; first, that the Commonwealth was obligated by a contract created by the legislature in Section 1010 of the Business Corporations Law of 1933, 15 PS 2852, to treat domestic and foreign corporations with equality in all matters, including taxation, and, second, that foreign corporations have not been so treated because of the substitution of the present franchise for the capital stock tax previously imposed upon them. Without discussing the first assumption, or considering whether the asserted contract was limited by implicit or explicit reservations of power to the Commonwealth to revoke or modify the authority granted a foreign corporation to do business here, we may dispose of this constitutional objection briefly by pointing out that appellant has failed to prove discrimination by the State against it, as a foreign corporation, in favor of domestic corporations. *Equality* of treatment does not, as we have heretofore stated, require or imply *identity* of treatment. It is not necessary to impose upon domestic and foreign corporations identical taxes by identical methods. An equivalent tax burden is imposed on both classes of corporations, which is a sufficient compliance with the contract appellant derives from the section of the business Corporation Law cited. We have examined most carefully the briefs in this case, and in a companion case, *Commonwealth v. The Quaker Oats Company* (opinion this day filed), including the brief of amici curiae., and have found in them no controlling authority contrary to our conclusion.

The judgment of the court below is affirmed; costs to be paid by appellant.

Certified A True Copy

(S.) Helen W. Speck,
Deputy Prothonotary.

APPENDIX "D"

IN THE SUPREME COURT OF PENNSYLVANIA, MIDDLE DISTRICT

No. 53 May Term, 1939

COMMONWEALTH OF PENNSYLVANIA, Appellant,

v.

COLUMBIA GAS AND ELECTRIC CORPORATION

Appeal from Final Judgment of the Court of Common Pleas of Dauphin County

Opinion of the Court

KEPHART, C. J.:

On October 2, 1933, the Columbia Gas and Electric Company, a Delaware corporation, with its principal office in New York, applied for and obtained a certificate of authority to transact in Pennsylvania the business of "production of oil, gas and electricity and holding of real estate." From that date until October 31, 1935, it owned and operated in this State plants for the manufacture of gasoline and natural gas. In the conduct of that business for the year 1935 it employed tangible property of a book value of $331,813.39, paid wages of $14,926.27 and received from sales $31,451.47, all within or assignable to the State.

The company's corporate powers and businesses were broader than those which it qualified to pursue in Pennsylvania. The great bulk of its activities consisted in acting as a holding company. It owned 50% to 100% of the stock of some 50 subsidiaries, a substantial investment in stocks, bonds, mortgages and notes of other companies, and had a large amount of accounts receivable and cash. In 1935 the total value of these intangible assets amounted to approximately $446,000,000. The court below found that the legal situs of this intangible property was outside of this State.

Upon the withdrawal of the company from this State at the end of October, 1935, it filed a franchise tax report for 10 months, setting forth the following information:

Appraised value of entire capital stock	$188,862,501.00
Tangible property in Pennsylvania	331,813.00
Total tangible property	475,328.00
Wages paid in Pennsylvania	14,926.00
Total wages paid	453,612.00
Gross receipts assignable to Pennsylvania	31,451.00
Total gross receipts	18,257,245.00

The Commonwealth, pursuant to the amendatory Act of May 16, 1935, P. L. 184, settled the tax as follows:

Value of capital stock as appraised by Department of Revenue	$188,862,501.00
331,813.39 × ⅓ of 188,862.501 =	43,946.491.
475,328.86	
14,926.27 × ⅓ of 188,862.501 =	2,071.528.
453,612.37	
31,451.47 × ⅓ of 188,862.501 =	108,450.
18,257,245.78	
Taxable value of Capital Stock	46,126.469.
Tax of Five Mills	192,193.63
Penalty	.....
Amount due Commonwealth	192,193.63

An appeal was taken to the court below from this settlement of tax by the Revenue Department.

The taxing officials, from the argument presented in this Court, evidently based the settlement upon the assumption that the company was doing a holding company business in this State because of the following facts: The company had under lease several floors of the Union Trust Company Building in Pittsburgh at a rental of $80,000. per year,

which, in turn, was billed proportionately to the operating subsidiaries in Pennsylvania. The company had on deposit in the Union Trust Company from $1,300,000. to $1,400,000. From this account loans were made to its subsidiaries and repaid by them into it; into the account were received dividends of upwards of $658,000., and approximately $522,000., representing the proceeds of gas sold by appellee to another company.

However, the court below found that the executive business of the company was transacted, and all meetings of the stockholders and directors were held, out of the State; the stock certificates of subsidiaries, bonds, mortgages and other evidence of indebtedness were kept, and interest and dividends were received, outside of this State, except those sent for deposit to Pittsburgh, which were immediately entered upon the books of the New York City office. It concluded from this, as well as other evidence, that the company did not conduct a holding company business in this State. It then found that the amendment imposed a franchise tax on foreign corporations; that such tax measured by the capital stock was subject to constitutional restrictions imposed by the due process, equal protection and interstate commerce clauses of the Federal Constitution; that the allocation of taxable value to this State must bear a fair relation to the amount of local business done here by the foreign corporation; that, in this instance, the apportionment formula resulted in allocating a too large taxable value to Pennsylvania, principally because of the large amount of intangible properties which were located in another State and used solely in the performance of the holding company functions. The court concluded that the formula and allocation fractions prescribed by the statute to ascertain the taxable value of the franchise, operated not only unreasonably in the case of the Columbia Gas & Electric Company but were

> "* * * inherent in the method of allocation, and arbitrarily and unreasonably affect every corporation which has a substantial part of its intangible property outside of the State, because under the system pre-

> scribed by the Act intangible property is brought proportionately into the State for a base upon which to apply the tax."

It therefore declared the Act unconstitutional generally. From this decision the Commonwealth has appealed.

Prior to 1935 both domestic and foreign corporations were subject to the capital stock tax imposed by the Act of June 1, 1889, P. L. 420, as amended April 25, 1929, P. L. 657. Domestic corporations paid a tax of 5 mills on the whole amount of their capital stock less certain exemptions. Foreign corporations paid a tax at the same rate on that proportion of the value of their entire capital stock which the tangible assets within the State bore to all assets of the company.

The amendatory Act of May 16, 1935, P. L. 184, is entitled:

> "An Act to Further Amend * * * by substituting a Franchise Tax on Foreign Corporations in lieu of the Capital Stock Tax on such Corporations."

Section 21B of the Act provides:

> "Every foreign corporation * * * shall be subject to and pay * * * a franchise tax at the rate of 5 mills upon a taxable value to be determined in the following manner: The actual value of its whole capital stock of all kinds, including common, special and preferred shall be ascertained in the manner prescribed in the 20th Section of this Act and shall then be divided into three equal parts."

To each one-third of the value of this entire capital stock there are applied certain fractions, representative of the fundamental elements of corporate structure, that there may be determined the taxable value allocable to this State to which the tax rate is to be applied. In the first fraction the numerator is the value of tangible property within the State and the denominator is the value of the entire tangible property wherever situated. In the second fraction the numerator is the gross expenditure for wages, salaries, commissions, etcetera paid in this State and the denomi-

nator the wages, etcetera, of all employes everywhere. In the third fraction the numerator is the gross receipts from business assignable to the State and the denominator is the total gross receipts from all business. As above noted, each fraction is applied against one-third of the value of the capital stock. Their sum total represents the taxable value.

Prior to the Act of 1935 the tax imposed on capital stock of foreign corporations, as well as domestic, had been repeatedly held to be a property tax.[1] Guided by what was stated in *Commonwealth* v. *Standard Oil Company*, 101 Pa. 119, and *Commonwealth* v. *Curtis Publishing Co.*, 237 Pa. 333, it became the practice to tax only so much of the capital stock of a foreign corporation as the ratio of tangible assets in the State bore to all assets of the foreign corporation wherever situated. Under this arrangement foreign corporations, transacting a large part of their business here, escaped their fair share of the tax burden. The assets of foreign corporations, so far as they were comprised of intangibles, were wholly free of tax notwithstanding that they may have played an important part in the conduct of the company's local business. The old tax did not even reach all the tangible property of the enterprise located in this State. It made no attempt to value foreign corporations either as going concerns within this State, or as parts of going concerns which the foreign corporations had created through operations in this and other states. The discrimination under the old tax law was not only unfair, but operated unjustly in favor of foreign corporations, and against domestic corporations, even though they might be similarly situated. It is the old tax which appellee seeks to reestablish notwithstanding the fact that the capital stock tax imposed on domestic corporations both before and after 1935 taxes their intangibles, subject to certain exemptions.[2]

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[1] See *Com. v. Standard Oil Co.*, 101 Pa. 119; *Com. v. New York, Penna. and Ohio R. R. Co.*, 188 Pa. 169; *Dupuy v. Johns*, 261 Pa. 40; *Callery's Appeal*, 272 Pa. 255.

[2] See the Act of June 22, 1931, P. L. 687; *Com. v. Eastern Securities Co.*, 309 Pa. 44; *Com. v. Penna. R. R. Co.*, 297 Pa. 308; *Com. v. Shenango Furnace Co.*, 268 Pa. 283.

The legislature sought to remedy this condition by amending the law so that foreign corporations would pay substantially the same amount of tax as domestic corporations though the amount of the tax was arrived at by a different method. The new tax is more in keeping with the benefits received from this State. The tax base represents the value of their right to do business in this State.[3]

The discrimination which had existed in the tax treatment of foreign and domestic corporations might have been remedied by other methods, but it is not for the courts to determine the wisdom of the means chosen to accomplish a given equitable result. The legislature is the sole body to determine that question. It is only left to us to decide whether the system violates fundamental law.[4] Judge Hargest, of the court below, stated: "It (the franchise tax) is certainly a new tax and a new system of arriving at the taxable value;" The method does depart from the system or method heretofore existing of ascertaining the taxable value on which the tax is levied, but it cannot be condemned because it is new. Experimentation in taxation by the legislature is as lawful as experimentation in other fields.[5]

Did the legislature intend to change its old policy of levying a property tax and create in its stead a franchise tax upon foreign corporations? We concur with the court below in its conclusion that the tax is a franchise tax and

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[3] This court stated in *Arrott's Est.*, 322 Pa. 367, 372: "The reason for the change in the method of computation is clear. . . . The old method of measuring the capital stock of foreign corporations doing business in this Commonwealth was unsatisfactory and produced an unfair result. To reach a more equitable measurement of the base for these corporations, . . . the Legislature concluded that a different standard was necessary. This finds expression in the formula contained in the Franchise Tax Act which takes into consideration the ratio of tangible assets in use in this state to all other tangible assets, together with other factors such as payroll and gross receipts."

[4] *Com. ex rel. Kelly v. Clark*, 327 Pa. 181; *Com. ex rel. Kelly v. Cantrell*, 327 Pa. 369; *Rohrer v. Milk Control Bd.*, 322 Pa. 257; *Grim v. Weissenberg*, 57 Pa. 433; *Busser v. Snyder*, 282 Pa. 440.

[5] In *Newark Fire Insurance Co. v. State Board of Tax Appeals*, 59 Sup. Ct. 918, it is stated: "Wise tax policy is one thing; constitutional prohibition quite another. The task of devising a means for distributing the

not a property tax. The legislature in the title to the Act called it a franchise tax. While not conclusive, some weight should be given to this designation in determining the nature of the tax. See *Opinion of the Justices*, 250 Mass. 591, 148 N. E. 889; *San Francisco* v. *Liverpool*, 74 Calif., 113, 15 P. 380. Whether this is a property tax or a franchise tax rests to some extent upon the method of its ascertainment and the incidence of the tax itself. Where a tax is imposed directly on specific property it is a property tax. The incidence of a franchise or privilege tax is upon a franchise or privilege and not upon property or capital. It is true we stated in *Arrott's Estate*, 322 Pa. 367, that there was a close identity between the old capital stock tax [a property tax] and the new franchise tax. But we were there determining whether the owners of shares of stock in foreign corporations which pay taxes to this State should pay a personal property tax on these shares. Having discovered that it was the evident purpose of the legislature to have domestic corporations pay a capital stock tax of 5 mills and foreign corporations a tax of 5 mills on a taxable value, of which an underlying element is capital stock, we held that there was enough similarity between the methods of taxing foreign and domestic corporations to render exempt from personal property tax the shares of stock in foreign corporations, just as shares of stock in domestic corporations were exempt. The basic problem in that case was not the nature of the tax imposed on foreign corporations by the 1935 Act, but rather the problem of the exemption from personal property tax of the shares of stock in such foreign corporations.

Among the standards used for distinguishing a franchise tax from a property tax has been the method adopted

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burdens of taxation equitably has always challenged the wisdom of the wise financial statesman. Never has this been more true than today when wealth has so largely become the capitalization of expectancies derived from a complicated network of human relations. The adjustment of such relationships with due regard to the promotion of enterprise and to the physical needs of different governments with which these relations are entwined, is peculiarly a phrase of empirical legislation. It belongs to that range of the experimental activities of government which should not be constrained by rigid and artificial legal concepts."

for laying them and fixing the amount.[6] It is true that under the Act of 1935 the value of the capital stock is used as an element, as provided in Section 20, but when this value is obtained the taxable value which is fixed by the apportionment method is not, nor can it be property in this State. In part, this is demonstrated by the considerations which enter into the valuation and appraisement of capital stock. Capital stock, as that term is employed in the Act, is a valuation of the corporation as a business enterprise, not an appraisement of bare worth of tangible and intangible properties. Section 20 of the Act makes it a reflection of the going-concern value of the entire organization. See *Commonwealth* v. *Delaware, Susquehanna & Schuylkill R. R.*, 165 Pa. 44, 48-49. The determination of the value of the franchise under the amendatory Act may bring into consideration property situated within the Commonwealth, and give to it a functional value as part of an organic unit. But the incidence of the tax is fixed upon the value of the franchise; not upon the property itself. To ascertain that taxable value there must, of course, be a method.

Under the 1935 Act, the underlying element in the ascertainment of the value of the franchise is the value of the entire capital stock of each foreign corporation. We referred to this in *Arrott's Estate*, 322 Pa. 367 as being the base. The attempt to determine what part of the value of this base should be the taxable value called for by the Act is to ascertain with approximate correctness the equivalence of that value which the legislature deemed the franchise or right to do business in this State to have.

Do the factors used in the income tax result in a fair method of determining the taxable measure which should be prescribed for the franchise to do business in this state?

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[6] It has been stated in *Com. v. Standard Oil Co.*, 101 Pa. 119: "The test, whether the tax in any given case is a franchise as distinguished from a property tax, would seem, from the authorities, to be that a tax according to a valuation is a tax on property, whereas a tax imposed according to nominal value, or measured by some standard of mere calculation—as contrasted with valuation-fixed by the law itself, may be a franchise tax." See also *Society for Savings v. Voite*, 6 Wall. (U. S.) 594.

Gross receipts necessarily indicate business done; they are derived from the use of intangibles as well as tangible assets. They are indicative of a going-concern value, which is inherent in the privilege of doing business in the Commonwealth. In applying against one-third of the value of the capital stock the ratio which the gross receipts within the State bear to the total gross receipts, the result must be to fairly proportion that part of the total taxable value which should be assigned to Pennsylvania. The Act considers the amount of tangible property in the State, compares it with all tangible property and applies it against the same base. Generally speaking, corporate business is transacted through the use of tangibles rather than intangibles. As the ratio of tangible assets in the State to tangibles situated everywhere varies so it may be said that the value of the corporate franchise within this state varies. Moreover, the intangible worth of a going corporation as well as intangible assets themselves may be said to have some degree of correlation as to situs with tangibles. It was undoubtedly within the power of the legislature to permit this correlation to be worked out through the use of a fraction which considered tangible assets only, leaving a more exact correspondence to be brought about through the interaction and effect of the other fractions composed of gross receipts and payrolls. The fraction composed of the ratio of payroll within this State to payroll everywhere is indicative of corporate activity within this State, whether in the form of manufacturing, selling or otherwise. As these activities increase within this State so it may be said the value of the right to do business in this State increases. If the legislature had chosen to use a single one of these fractions and applied the same to the entire capital stock, certainly it could hardly be contended that it would be without its powers,[7] provided

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[7] In *Roberts & Schaefer Co. v. Emmerson*, 271 U. S. 50, a franchise tax on that proportion of authorized capital stock represented *by business transacted and property* located within the state was upheld. In *International Shoe Co. v. Shartel*, 279 U. S. 429, a franchise tax imposed on foreign corporations on that part of their outstanding capital stock and surplus which the property and assets of the foreign corporation within

proper consideration be given in each case to the elements to be included or omitted in determining the value of the entire capital stock as the measure of the tax. The use of all three and the application of each to one-third of the entire capital stock value is simply an attempt to make the ultimate measure to which the tax is to be applied more representative of the actual worth of the franchise to do business and to allow the interplay of the factors to average out the hardship which might arise by reliance upon any single one.

The Act provides for the ascertainment of taxable value by a measure. In its process it applies allocating fractions to each foreign corporation's entire capital stock value. These fractions, as stated above, concern corporate activity. While they bear some relation to capital stock value, intrinsically they determine the taxable value of the corporate activity within this State rather than of the property located here. That it is the value of the franchise rather than the actual value of the property which is taken into account is clear from the factors which enter into the apportionment. They are the same which this Court considered in *Turco Paint & Varnish Co. v. Kalodner*, 320 Pa. 421, where income was the fundamental base. It does not ascertain physical worth of assets located in this State, but arrives at a value which the functional or operating organic unit within this State possesses. It represents what the right to do business is worth. It must follow that the tax is not levied on property but on the franchise to do business measured by a taxable value secured through the ap-

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the state bore to all assets and property of the foreign corporation, wherever situated, was upheld. In *Hump Hair Pin Mfg. Co. v. Emmerson*, 254 U. S. 290, a tax on that proportion of the capital stock determined by averaging the percentage of the total business of the corporation transacted within the state and the percentage of the total tangible property located within this state was upheld. With respect to apportionment of income, there has been sustained an apportionment based upon tangible assets within a state to all tangibles wherever situated; See *Maxwell v. Kent-Coffey Mfg. Co.*, 291 U. S. 642; gross business within the state added to value of property within the state to total gross business and value of total gross assets. See *U. S. Glue Co. v. Town of Oak Creek*, 247 U. S. 321.

plication of the factors of gross receipts, tangibles and payrolls to the capital stock value. It is representative of the value of that very franchise.

Appellee contends that because a corporation's capital stock may be composed of intangible assets more or less of which may be used in connection with the business done in this State, the formula is inherently arbitrary because the factors do not take this element into consideration. In place of the fraction tangible assets in the State over all tangible assets of the corporation, it contends the fraction should be tangible and intangible assets within the State over entire tangible and intangible assets wherever situate. This argument would have much weight if the legislature were endeavoring to measure property within the State. Since, however, the tax is upon the value of a privilege, it is not necessary that there be an exact measurement of the intangibles within this state. In *Kansas City, Memphis & Birmingham R. R. Co. v. Stiles*, 242 U. S. 111, the Court stated, "While a state cannot tax beyond its borders it may measure a tax within its authority by capital stock which in part represents property without the borders of the state". Moreover, as previously pointed out, there is embraced within the formula factors which bear relation to the intangibles.

In applying the formula set up by the legislature since the value of the capital stock is used as a measure, the taxable value of the franchise must have some relation to the business done in the taxing state. The Supreme Court of the United States in a number of cases has held that in fixing the taxable value with reference to property and business done within the state where capital stock is used as a measure, the property without the state may be taken into consideration only if it is an organic or functional part of that within the state. See *Fargo v. Hart*, 193 U. S. 490; *Wallace v. Hine*, 253 U. S. 66; *Norfolk & W. Ry. Co. v. State of North Carolina*, 297 U. S. 682. Where the intangibles are a necessary part of the corporate activity and are within the scheme of corporate functioning, actively or as reserve, there is no reason why they should not be included. If the intangibles acquire a business situs, they, of course

are properly included. See *Commonwealth v. Curtis Publishing Co.*, 237 Pa. 333; *Wheeling Steel Corp., v. Fox*, 298 U. S. 195. Viewing the Act as a whole it cannot be declared to violate either the Federal or State Constitutions or to be so inherently arbitrary as to render it unconstitutional.

It is contended, however, that even if the Act is structurally sound, as to appellee there is an unconstitutional application. An act may be constitutional structurally and yet not in its application to one or more corporations. It is almost impossible for any legislature to fix with certainty a tax measure which will work out equal and exact justice in every instance. But it would be subversive of all government for a court to arbitrarily invalidate an act of assembly because in its judgment the act might be invalid in one or more cases. As was stated in *Field v. Clark*, 143 U. S. 649, at pages 696-697:

> "a general revenue statute should never be declared inoperative in all its parts because a particular part relating to a distinct subject may be invalid. A different rule might be disastrous to the financial operations of the government and produce the utmost confusion in the business of the entire country."

It is the duty of the courts to sustain the government's measure if it is at all possible to do so. This is plainly illustrated in our zoning laws which we held to be structurally constitutional, although in given instances they might work confiscation.

In *Turco Paint & Varnish Co. v. Kalodner*, 320 Pa. 421, at page 430, we stated of the Corporate Net Income Tax Act and the formula prescribed in it:

> "The method or formula stands as the prima facie method of determining the net income. If, in particular cases, its operation will work an injustice or achieve an arbitrary result so far out of line with the actual facts as to cause it to be illegal, or if, in its application, it touches upon particular corporations, which, because

of their paramount federal interest, have been held to be immune from burdensome state taxation, then will be the time to consider such charges."

Appellee performs only a part of its functions within the state, and in connection therewith, employs a part of its tangible and some intangible property. Under the principles relating to corporations engaging in multiform business and considering that only part of appellee's business is conducted in Pennsylvania, as far as the capital stock value is related to tangible and intangible property, only such tangibles and intangibles should be taken into account as are concerned with the functions exercised within the state. The facts show under appellee's certificate it is permitted to and has actually limited its business to that of a manufacturing or operating company. The vast amount of its property consists of intangibles used in connection with its holding company business. The record does not disclose satisfactorily that it performs any part of that business within this State. Its power to act as a holding company is authorized under the laws of Delaware. It is obvious therefore that to include within the taxable measure all the property used in connection with this function would be to levy a franchise tax having no relation to the privilege granted by this State to appellee as an operating company or to any function actually performed herein. Analogies are not lacking to sustain this view that such action would violate constitutional privilege. In *Roberts & Schaefer Co. v. Emmerson*, 271 U. S. 50, the Court stated (page 54) of the holding in *Air-Way Electric Appliance Corp. v. Day*, 266 U. S. 71 that a privilege tax could not be levied on authorized capital stock because

"The authority to issue its [the foreign corporation's] capital stock was a privilege conferred by another State and bore no relation to any franchise granted to it by the State of Ohio or to its business and property within that State."

See also *Great Atlantic & Pacific Tea Co. v. Grosjean*, 301 U. S. 412. In *Ozark Pipe Line Corp. v. Monier*, et al, 266 U. S. 555, the Court said (pages 566-567)

> "* * * so far as this case is concerned the *power to tax depends upon what was done and not upon what might have been done. Moreover, the license issued by the State authorized appellant to engage 'exclusively in the business of transporting crude petroleum by pipe line'.*"

In view of the fact that the legislature intended only to levy a tax on a measure fairly representative of the corporation's franchise to do business in this State, under the exceptional situation here presented, it is the duty of the Court to construe the Act so as to cause the statute's application to be both constitutional and fair.

Instances are not lacking in which courts have so construed statutes as to uphold them and yet avoid arbitrary results. See *People ex rel. Alpha Portland Cement Co.* 230 N. Y. 48; *People v. Knapp*, 129 N. E. 207; *Ratheman v. Western Union Telegraph Co.*, 127 U. S. 411; *Singer Sewing Machine Co. v. Brickel*, 233 U. S. 304; *Bowman v. Continental Oil Co.* 256 U. S. 642. In *Commonwealth v. Standard Oil Co.* 101 Pa. 119, where the Court had under consideration our previous capital stock tax act, in answer to an argument that the tax in effect brought within the tax base the entire capital stock of a foreign corporation, the Court stated:

> "we must construe them to mean so much of the capital stock measured by the property actually brought within the state by the company in the transaction of its business."

By these principles it is obvious that since the tax is nothing but one upon the value of a privilege and the taxable measure is fundamentally the capital stock used in connection with that privilege, we must for the purpose of determining the validity of the tax separate from it that capital stock value which bears no relation to the privilege. In determining the franchise tax to be levied on the Col-

umbia Gas and Electric Company, the value of its assets represented by capital stock used in connection with its holding company business should have been excluded by the taxing officials. In so holding it is to be understood that not all intangibles are to be disregarded for, to the extent that intangibles enter into the exercise of the franchise conferred by this state or privileges actually exercised within the state, such intangible value must properly be included. This redetermination of the tax due the Commonwealth will also require a readjustment in the figures prescribed in the statutory formula. For purposes of making the correct calculation of tax due, it will be essential that the separate phases of the business be determined not only with respect to capital stock values, but also with respect to computation of the statutory fractions.

There may be cases in which a foreign corporation pursues in this State, not merely one (as in the present case), but all the activities in which it engages in the state of its domicile, and nevertheless it may own assets, tangibles or intangibles, in its domiciliary state, which bear no fair relation to the value of the franchise enjoyed by the corporation in this State. In such cases such assets must be excluded from the value of the entire capital stock in determining the measure of the tax. Cf. *Hans Rees' Sons v. North Carolina*, 283 U. S. 123.

There are some further objections to the new Act's embodying part of the old Act and to the taking away of the exemption applicable to manufacturing corporations. These are very fully answered by the court below in holding that the tax was for the privilege of doing business in the Commonwealth and was not a property tax.

Appellee also contends that the act is invalid because it discriminates against foreign corporations in favor of domestic ones and therefore violates the equal protection clause of the Federal Constitution. It is sufficient answer to say that this is not a tax in addition to one already imposed, but a new tax which will bring foreign corporations up to the same plane of taxation as domestic corporations. It is scarcely necessary to cite authorities that a state may differentiate in its method of taxing between foreign and

domestic corporations. See *Concordia Fire Ins. Co. v. People of the State of Illinois*, 292 U. S. 535. If it attempted to impose a greater tax burden on foreign corporations than it did on domestic corporations similarly situated appellee would have a just cause of complaint.[8]

The result of the Act's operation is not so obviously wrong and so out of proportion to the business done and property within the State that it can be said to be confiscatory or discriminatory compared with similar domiciliary corporations. In the light of this opinion there is no imposition or unjust burden on this foreign corporation.

Another feature that has been called to our attention is that of unjust discrimination against foreign corporations as to the exemptions allowed domestic corporations. But the conclusion arrived at herein renders discussion of this argument unnecessary. The subject matter of the domestic corporation exemptions is the stock of subsidiaries. These no longer enter into the calculation of value of appellee's capital stock. This issue therefore disappears from the case.

Judgment reversed. The record is remitted to the court below with instructions that it be returned to the Department of Revenue to resettle the tax against appellee in accordance with this opinion.

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[8] It was stated at the Bar of the Court that there were many hundreds of appeals under this Act. The Attorney General informed the Court that up to June 23, 1939, there were 7,780 foreign corporations liable to a franchise tax. During the operation of this statute there were upwards of 23,000 tax settlements made pursuant thereto and of this number there have been appealed to the Court 816. Of this latter figure there are but 306 appeals which raise the constitutionality of the Franchise Act. The remainder are factual disputes. In other words 3½% of the tax settlements have been appealed. There is only approximately 1½% on constitutional questions.